Spanning the Generations

PepsiCo, Inc. 1987

Spanning the generations...
By keeping our products contemporary, we appeal to an increasing number of consumers in every age group in every part of the world.

This continuing focus on profitable growth made 1987 the best year in PepsiCo's history. The future is even more promising.

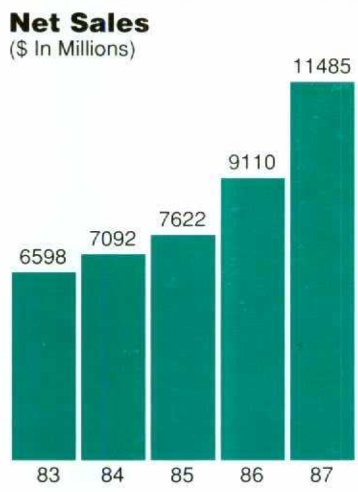
Contents

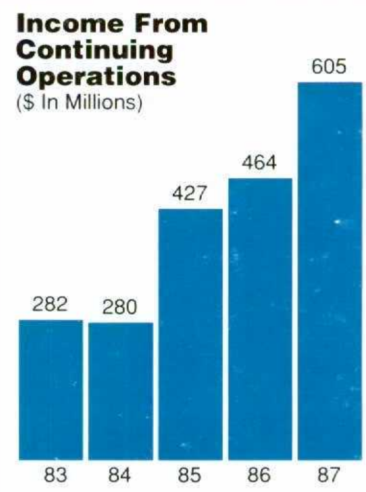
Financial Summary

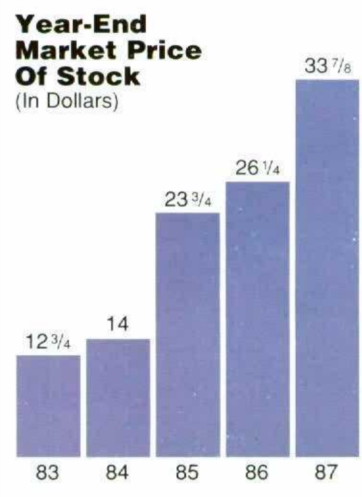
($ in millions except per share amounts)	1987	1986	Percent Change
Net sales	$11,485	9,110	+26
Income from continuing operations	$ 605	464	+30
Per Share	$ 2.30	1.77	+30
Net income	$ 595	458	+30
Per Share	$ 2.26	1.75	+29
Cash dividends declared	$ 175	163	+ 7
Per Share	$ 0.67	0.63	+ 7
Property, plant and equipment expenditures	$ 775	882	−12
Cash generated by continuing operations	$ 1,379	1,234	+12
Shareholders' equity per share	$ 9.64	7.91	+22
Return on average shareholders' equity	% 26.5	23.8	+11

The results of MEI Corporation, Seven-Up International and Kentucky Fried Chicken are included from their respective dates of acquisition in 1986.

Return on average shareholders' equity was calculated using income from continuing operations.







To Our Shareholders and Employees:

I'm very pleased to report that in 1987 we achieved record sales and operating profits in each of our three businesses: soft drinks, snack foods and restaurants. These excellent results were based primarily on volume increases, market share gains and continuing improvements in profit margins.

This strong and well-balanced operating performance raised our overall financial results to record levels. Our achievements are particularly impressive because they represent major gains from a strong 1986:

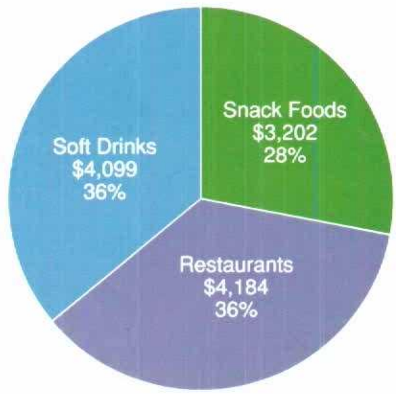
- Income from continuing operations increased 30% to $605 million.
- Sales were up 26% to $11.5 billion.
- Operating cash flow reached an all-time high of nearly $1.4 billion.
- Return on average shareholders' equity was our highest in history–26.5%.

I want to call to your attention three important strategic considerations that contributed to our success in 1987:

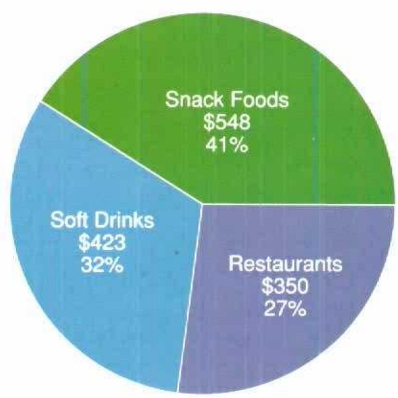
1. our continuing ability to generate increased sales of our products,
2. improvements we've made in our operating margins by increasing the efficiency of our existing businesses, and
3. the profitable growth we've created from new operations.

These factors will have a major impact on the vitality and profitability of our businesses for many years to come.

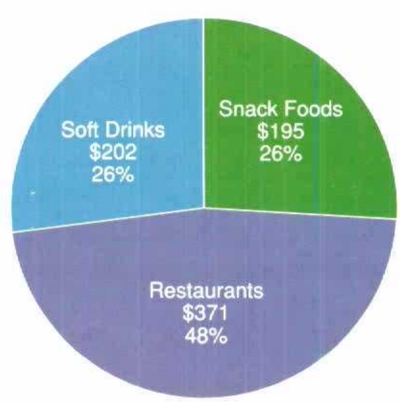
Segment Net Sales
Total: $11,485
($ In Millions)



Segment Operating Profits
Total: $1,321
($ In Millions)



Segment Capital Spending
Total: $768
($ In Millions)



1. Continuing Volume Gains by Segmenting Markets

The first of these strategic considerations deals with our ability to stimulate continuing growth in the consumption of our products.

Our products are popular with all age groups, but teenagers and young adults tend to be the biggest consumers. And, as these age groups were swelled by the "baby boom" generation, our sales volumes rose–as would be expected. But as this generation ages, our growth rates show no signs of leveling. In fact, sales of our products continue to rise.

The reason: Consumers are taking their food and beverage habits with them as they age.

As the teenagers of 10 and 20 years ago grew older, they didn't lose their taste for soft drinks, snack foods and quick service restaurants. Their preferences change, of course, to reflect more contemporary interests. For example, the taste for brand Pepsi acquired during teenage years becomes a preference for Diet Pepsi later in life, when calories become more of a concern.

By keeping our products contemporary, we can retain the brand

loyalty of our consumers. We do this primarily through youthful product imagery and by segmenting our markets.

Consumers want variety – new and different taste sensations. And so we develop great-tasting new products – primarily line extensions of existing brands. Consider the success of Cool Ranch Doritos. This one new flavor accounted for retail sales of $218 million in 1987.

In the restaurant business, each new generation is becoming increasingly accustomed to the convenience of food prepared away from home. This pattern is reinforced by major demographic trends, including the increasing number of two-wage-earner families and single person households. We can accelerate this growth by offering contemporary menu choices and distribution channels – carry-out, home delivery and foods that are easy to eat on-the-go. These actions increase both our customer base and their consumption levels.

Keeping Contemporary: Implications for Growth

The fact that consumers of all ages are retaining their habits has several important and very positive implications for us.

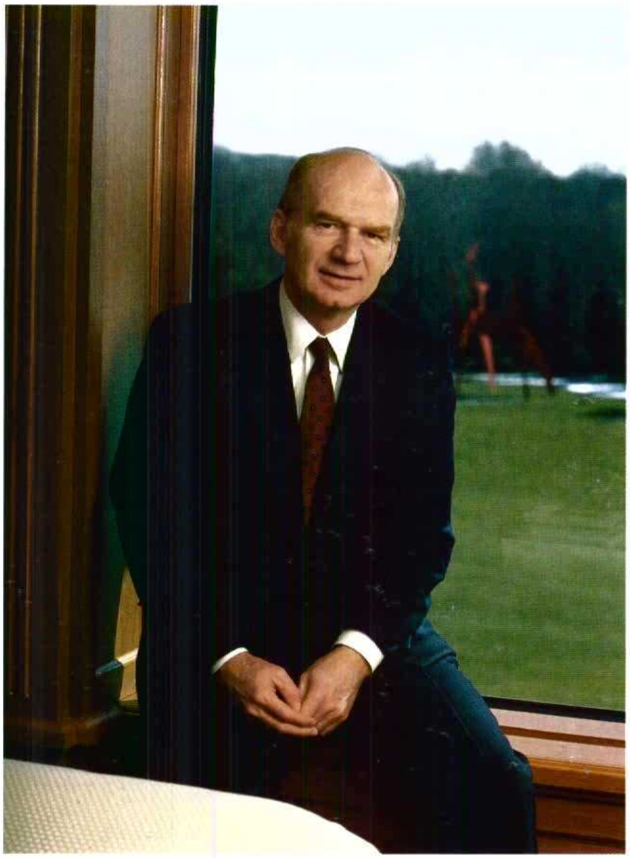
First, despite already high consumption levels, there still are significant growth opportunities for our major brands. And whatever we do to stimulate consumption will pay handsome dividends for many years to come. That's because each increase establishes a new and higher base on which we can build consumption within every successive age group.

Second, the consumer equity that we continue to build in big brand names becomes even more important as these brands are introduced to new generations of consumers. This gives our brands a seemingly unlimited life cycle. Considering the youthful and up-to-date images of our brands, it's easy to forget that many of them have been favorites for 30 or 40 years. In fact, Pepsi-Cola celebrates its 90th birthday this year.

Throughout this Report you'll see examples of actions we're taking to ensure our continuing ability to span the generations with contemporary products.

Third, because of the vitality of our products, we're not forced to venture into totally new markets to generate profitable growth and high returns. We can build our business by developing line extensions of existing products.

Line extensions are a low risk and very profitable way to grow. Our operating and distribution systems already are in place. Our manufacturing and food preparation processes require only minor modification. And consumers already are very familiar with our



D. Wayne Calloway
Chairman of the Board and Chief Executive Officer

brands – some of the most widely recognized and heavily promoted names in the world.

There's an added benefit in using line extensions to build our business. The excitement and promotional activity generated by new products stimulates sales of our existing products as well.

2. Improving Margins by Honing Operating Skills

Our accomplishments as a marketing company have been recognized widely. But our success is equally based on well-honed operating and executional skills. These enable us to continually improve our operating margins by increasing the efficiency of our manufacturing and distribution systems.

Our domestic and international business systems are very sophisticated and extremely complex. They include nearly 1,000 soft drink bottling plants, snack food manufacturing and distribution networks encompassing 1,900 facilities and 17,000 salespeople, and three restaurant chains totaling nearly 16,500 units worldwide.

Any reduction in costs or improvement in operating efficiency can be implemented quickly throughout an entire system. And because our businesses are very sensitive to margin improvements, even small gains can produce big results.

For example, each time we can improve our overall operating profit margin by one-tenth of 1%, we generate more than $11 million in additional operating profits. That's why margin improvement remains a continuing priority for us.

3. Profitable Growth From Very Selective Acquisitions

In addition to increasing sales and improving margins, we've created additional value for our shareholders by acquiring carefully selected new operations within existing businesses. Consider our acquisitions of Kentucky Fried Chicken (KFC), MEI Corporation and Seven-Up International – all made in 1986 at a total cost of $1.7 billion.

Acquisitions normally require several years to produce a positive return. But because of a very focused acquisition strategy that carefully measures operating synergies and financial returns, we've been able to accelerate that process dramatically. In 1987 these operations not only produced a positive return, they actually accounted for 35% of the increase in our earnings per share.

More than half of this earnings increase came from Kentucky Fried Chicken. This acquisition significantly strengthened our position in the quick service restaurant business, particularly in international markets. The entire KFC system

has been smoothly integrated into the PepsiCo family, and we look forward to the contributions of KFC employees, franchisees and joint venture partners to our continuing growth all around the world.

Our ability to quickly generate profitable growth from new investments allows us to take full advantage of the significant amounts of cash generated by all three of our businesses. And these businesses provide excellent opportunities to profitably reinvest that cash in existing operations or in closely related acquisitions.

Our objective is not merely to grow, but to grow *profitably*. The significant increase we achieved last year in our return on average shareholders' equity – to a record level of 26.5% – is clear evidence of this commitment.

We've demonstrated the ability to achieve profitable growth by increasing volumes, improving margins, and aggressively managing a well-balanced portfolio of operating and financial resources. In the years ahead, I'm confident that we will continue to achieve outstanding results. The major objectives we'll use to measure our success include:

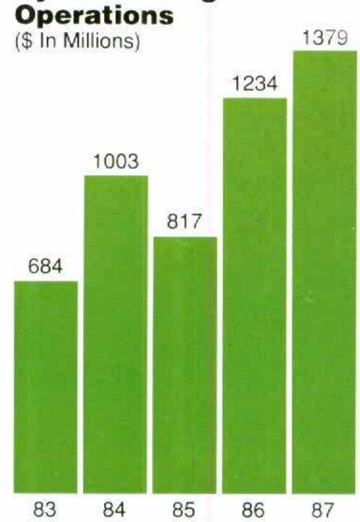
- double-digit profit growth within each business segment;
- strong operating cash flow, reinvested at returns that exceed our cost of capital;
- a return on average shareholders' equity of at least 23%, and
- prudent financial leverage, with a net debt-to-capital ratio of 35-40%.

When Don Kendall and the late Herman Lay founded our corporation in 1965, their objective was to create one of the truly distinguished consumer products companies in the world. Today, the 225,000 men and women of PepsiCo do not consider our past accomplishments a fulfillment of that objective. We view them as an indication of even greater success we can achieve in the future.

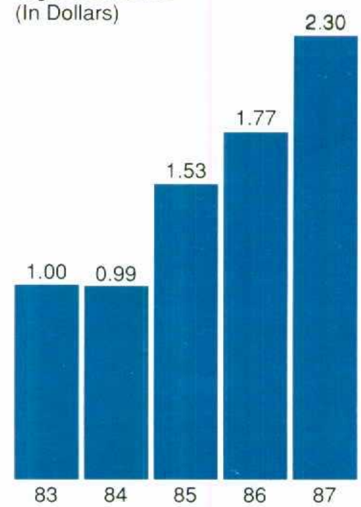
Wayne Calloway

D. Wayne Calloway
Chairman of the Board and Chief Executive Officer
February 25, 1988

Cash Generated By Continuing Operations
($ In Millions)



Income Per Share From Continuing Operations
(In Dollars)



Soft Drinks

PepsiCo has achieved a leadership position in three major domestic and international markets: soft drinks, snack foods and restaurants.

Our overriding corporate objective is to maximize shareholder value.

Our strategy is to concentrate our financial and managerial resources on large and rapidly growing consumer markets that offer us the opportunity to shape our own destiny and to earn exceptional returns.

We supplement internally generated growth by acquiring carefully selected operations within our existing businesses.

Divisions	Pepsi-Cola Company Pepsi-Cola International
($ In Millions)	
1987 Sales	$ 4,099
Growth over 1986	+19%
1987 Operating Profits	$ 423
Growth over 1986	+21%
U.S. Market at Retail	$40,000
PepsiCo Share	$13,000 The Pepsi-Cola system has approximately one-third of the U.S. soft drink market.
U.S. Industry Growth	+4.5%
PepsiCo U.S. Growth	+6.3% The Pepsi-Cola system's volume growth continues to outpace the soft drink industry.

Performance Highlights

- Brand Pepsi reaches $7.7 billion in retail sales.
- Diet Pepsi achieves double-digit growth for the fourth year in a row.
- Burger King fountain beverage contract renewed.
- Diet Mountain Dew introduced.
- Franchisees strengthen our business in Brazil and Italy.
- New joint venture with IC Industries creates second largest Pepsi-Cola bottler in United States.

Snack Foods

Restaurants

Frito-Lay, Inc. PepsiCo Foods International	Kentucky Fried Chicken Corp. Pizza Hut, Inc. Taco Bell Corp. PepsiCo Food Service International
$ 3,202	**$ 4,184**
+6%	**+58%**
$ 548	**$ 350**
+60%	**+57%**
$30,000	**$56,000**
$ 3,700 Frito-Lay is the leader in the U.S. salty snack market.	**$ 6,700** KFC, Pizza Hut and Taco Bell systems are the leaders in their quick service restaurant categories.
+4.3%	**+6.0%**
+5.0% Sales of Frito-Lay snacks consistently outperform the average grocery store product.	**+11.7%** Sales in PepsiCo's restaurant system are growing faster than the quick service restaurant industry.

Snack Foods

- Refocus on core brands and line extensions produces exceptional profit growth.
- Volume of Frito-Lay's core brands grows nearly 11%.
- Four Frito-Lay brands are among the top 10 of all dry food brands in supermarkets.
- International markets expand through acquisitions and joint ventures.

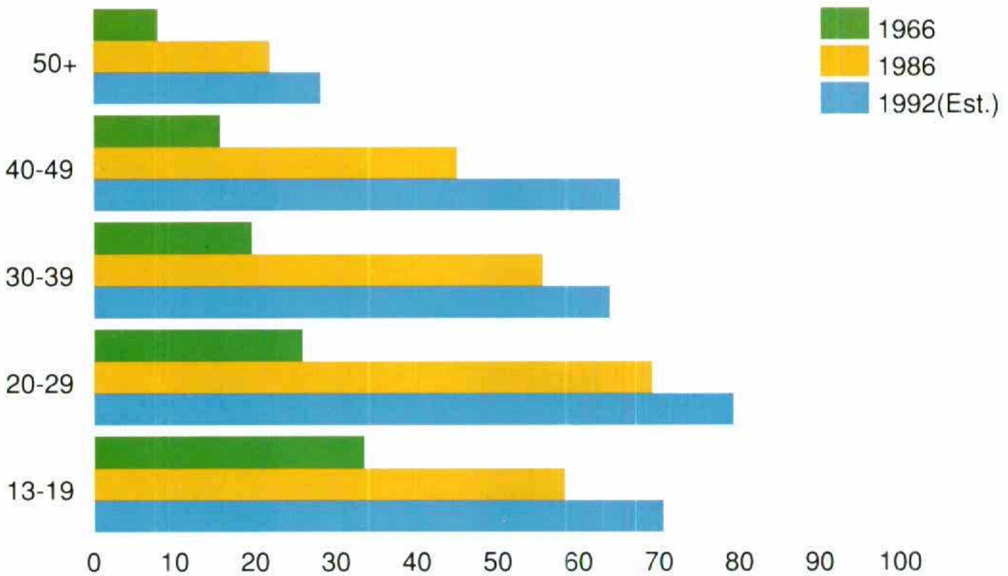
Restaurants

- PepsiCo's restaurant system, the largest in the world, reaches nearly 16,500 units.
- Chicken Littles sandwiches open up the lunchtime business for KFC.
- Pizza Hut Delivery is expanded.
- Taco Bell adds three new products.
- KFC opens world's largest quick service restaurant in Beijing.
- Pizza Hut expands international presence to 10 new countries.

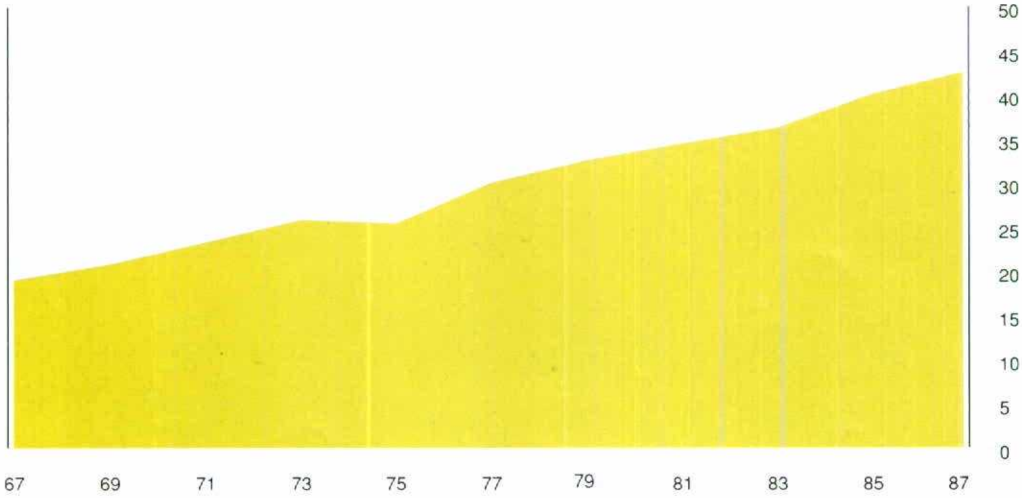
Soft Drinks—Consumers are taking their soft drink habits with them as they grow older, drinking more than consumers of the same age in previous years.

This phenomenon continues to generate higher soft drink consumption and increased industry sales year after year.

U.S. Soft Drink Consumption By Age Group
(Gallons Per Capita)

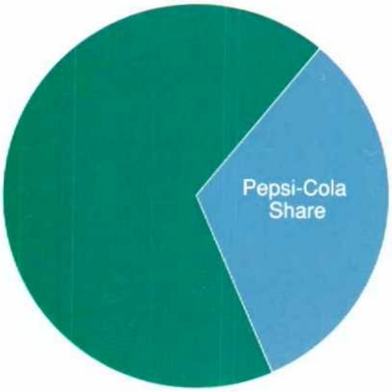


U.S. Soft Drink Consumption
(Gallons Per Capita)



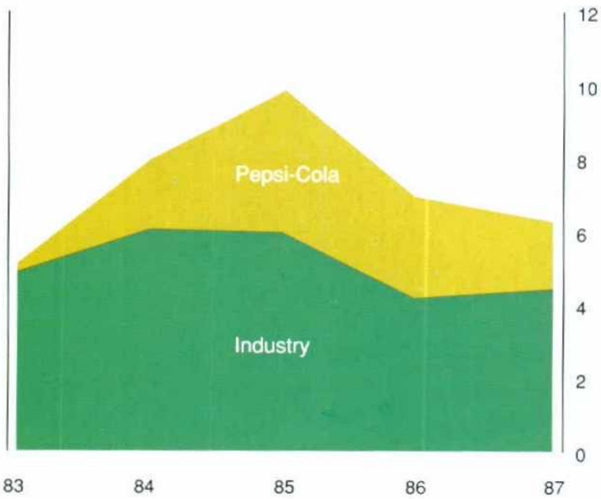

Soft Drinks
PEPSI

U.S. Soft Drink Industry Retail Sales Pepsi-Cola Share



U.S. retail sales of soft drinks total $40 billion. Pepsi-Cola brands account for nearly one-third of this growing market, with sales totaling $13 billion.

Pepsi-Cola System vs. U.S. Industry Case Sales Growth
(% Change)



Pepsi-Cola system case sales have achieved a five year compounded annual growth rate of 7.2%, about 40% faster than the industry.

Soft drink earnings increased 21% over a strong 1986 on a revenue gain of 19%. We set records for sales and profits worldwide, and reached an all-time high U.S. market share.

Industry Perspective

Young adults are the biggest consumers of soft drinks. As would be expected, consumption climbed in the 1960s, when members of the baby boom generation entered their teenage years.

But, rather than flattening as the baby boomers grew up, consumption is *still* climbing after nearly three decades. The reason: Baby boomers are taking their habit of enjoying soft drinks with them as they grow older. In fact, consumers between the ages of 40 to 49 drink nearly three times the amount of soft drinks as did consumers of this group in 1966.

At the same time, today's young people – still the primary market for soft drinks – are drinking more soft drinks than their parents did when they were growing up. In fact, consumers of every age group are drinking more soft drinks than their counterparts in prior generations. Rather than leveling off, soft drink consumption continues to reach new highs. In 1987 U.S. per capita consumption of soft drinks totaled about 43 gallons per year.

As consumers continue to enjoy soft drinks at record levels, the outlook for the industry in the United States is very bright.

Similar trends are found in international markets. Although per capita consumption in our markets averages under five gallons per year, low relative to the U.S., it's growing rapidly.

These trends lead to two significant conclusions. First, by remaining contemporary and competitive, we can sustain growth. Second, we can take measures to stimulate our markets and accelerate this growth. In other words, to a great extent we can control our future by the actions we take in our markets.

What follows is a look at our current market position and a report on what we are doing to accelerate profitable growth.

Current Position

• U.S. soft drink industry retail sales total more than $40 billion. Pepsi-Cola's share of that market is $13 billion–almost one-third.
• U.S. consumption of soft drinks over the last five years has been growing at an average annual rate of nearly 4% a year and shows no sign of leveling off.
• Pepsi-Cola brands are growing faster than the industry. While case sales in the U.S. industry grew at an estimated rate of 4.5% in 1987, Pepsi-Cola's 1987 U.S. system case sales increased by 6.3%.
• The Pepsi-Cola International (PCI) system has a 15% share of the estimated 12 billion case international market. PCI volume grew by 7% in 1987.
• Pepsi-Cola and Seven-Up products are available in nearly 150 countries around the world. Our franchised bottlers include some of the leading international companies.

U.S. Operating Systems

The Pepsi-Cola system combines the benefits and economies of scale of a large national company with the flexibility and decision-making speed of a local business.

Early in 1988, in order to be even more responsive to consumers, Pepsi-Cola reorganized its U.S. operations into four regional divisions, each responsible for company-owned, franchise and joint venture bottling operations in its region. Responsibilities encompass all distribution channels, including take-home, fountain and vending.

Franchisee and joint venture bottlers account for two-thirds of Pepsi-Cola sales. Company-owned bottling operations account for the remaining one-third of sales.

Company-owned bottling operations are among the most successful in Pepsi-Cola's bottling system. But financial performance is only one reason Pepsi-Cola owns bottling operations. In addition to generating profits, owning our own bottling operations offers critical marketing and operational insights and facilitates market testing, distribution and innovation.

Pepsi-Cola's fountain beverage operations work in partnership with bottlers to market soft drinks to restaurants, hotels, schools, hospitals and other national and local food service operations. This system, like our bottling system, combines the scope of a large national company with a focus on local service.

Distribution Channels

Pepsi-Cola products are marketed in all soft drink distribution channels.
• Supermarkets account for nearly 40% of all U.S. soft drink sales. Within this channel, Pepsi-Cola brands have about one-third of the market.

Brand Pepsi is the largest-selling soft drink in supermarkets

–and has been since 1977. In fact, soft drinks are the largest-selling product in the supermarket. And brand Pepsi is the largest-selling brand of *all* brands, of any product, in all supermarket categories.

• Fountain sales account for about one quarter of total U.S. soft drink industry sales. We began to increase our emphasis on the fountain channel in the late 1970s. Since then volume has almost doubled, and profits have more than tripled. The Pepsi-Cola system now has one-third of the fountain market.

• Vending sales account for approximately 13% of the U.S. soft drink market. As a result of a major expansion program, the Pepsi-Cola system has been buying vending machines at an average rate of more than 200 per day since 1984.

Accelerating Profitable Growth

Our business strategies build on our strong position in the soft drink industry. Here are four examples of how we accelerate our growth by executing these strategies.

1. Segment the market to reach more people with more products.

For example:

• Mountain Dew has long been a favorite of young, action-oriented consumers, primarily male. As the baby boomers move into their 40s, many of them are looking for a soft drink that doesn't add calories.

In 1987 we introduced Diet Mountain Dew, primarily to retain these longtime consumers as they become more calorie conscious. Now as a low calorie product, Diet Mountain Dew also is attracting more female consumers. Since consumption generally climbs when a consumer switches from a regular soft drink to a diet product, the outlook for Diet Mountain Dew is excellent.

In addition, as a result of increased consumer awareness of the brand, wherever Diet Mountain Dew has been introduced, sales of regular Mountain Dew also have climbed.

• Bottled water is the fastest-growing beverage segment. Per capita consumption has more than doubled since 1980. In 1987 we decided to test this increasingly attractive market by acquiring a spring water source and forming Great Spring Waters of America, Inc. We believe there is great potential in this underdeveloped beverage segment.

2. Expand through existing and new distribution channels.

With people of all ages drinking more soft drinks than ever before, making sure our products are broadly distributed is the key to growth. Here are examples of how we are expanding our markets:

• In 1987 Burger King, the world's second largest hamburger chain, renewed its contract to serve Pepsi-Cola products at its restaurants. Our presence in Burger King and other large accounts creates national awareness of Pepsi-Cola products, which helps to stimulate increased sales to local, regional and other national outlets. New fountain accounts include Hyatt Hotels and Sea World theme parks. Continental, Northwest and Pan Am airlines also now serve Pepsi-Cola products.

• Omnitron is our new computer-controlled fountain dispenser.

Omnitron dispenses soft drinks faster and with more consistent formulation than conventional systems, making it very attractive to fountain accounts.

In addition, since it handles a larger number of beverages than conventional systems, Omnitron allows the Pepsi-Cola system to offer more of our soft drink brands to fountain accounts. Mandarin orange Slice is a popular addition.

Pepsi-Cola has also developed Tea Breeze, an iced tea product specifically for fountain sales.

3. Stay contemporary to attract new generations of consumers.

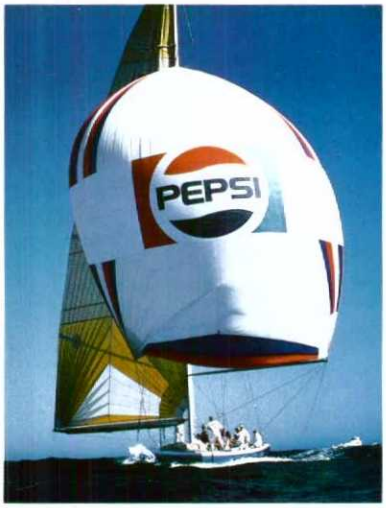
• Pepsi, a $7.7 billion brand at retail, is a 90-year-old product that we've kept young by continually developing innovative ideas to attract successive generations of consumers. Examples include entertainment marketing, such as promotion of worldwide concerts featuring big name rock stars, and special event marketing, such as co-sponsorship of the Stars and Stripes, winner of the America's Cup yacht race.
• Improved taste also keeps our products contemporary. At the end of 1987, we introduced a new smoother tasting lemon lime Slice. And in 1988 we're introducing an improved taste for Diet Pepsi.

4. Strengthen and expand our infrastructure to make us more competitive in existing markets and to reach new markets.

Through our business partnerships, we're positioning ourselves to grow in markets throughout the world. Here are some examples:
• IC Industries, Inc. – A joint venture created Pepsi-Cola's second largest bottler. The partnership, in the populous U.S. Midwest region where brand Pepsi already is the largest-selling cola, creates significant economies of scale and gives our products an even stronger presence in this key market.
• Britvic Corona, Ltd. – Our joint venture in the United Kingdom completed its first full year. Britvic is one of the United Kingdom's largest beverage companies, with an already well-established pub and restaurant trade. The new partnership achieved double-digit sales increases.
• Brahma – Our franchisee is the largest brewer in Brazil, the third largest soft drink market in the world. In 1987 our markets were expanded to the São Paulo region. As a result, our volume is growing significantly.
• San Benedetto is our newest franchisee in Italy, one of the world's top 10 soft drink markets. We expect this new business relationship to provide us with a long-term competitive advantage since San Benedetto is already among the most efficient producers of beverages in Italy.

Improving Productivity

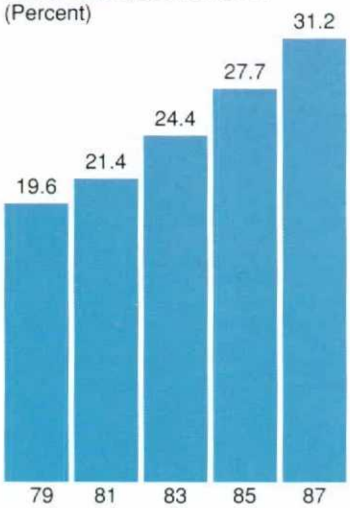
We increase profitability not only by growing the business, but also by improving productivity. The following programs reduced costs by more than $10 million in 1987 and will be expanded in 1988.
• Syrup delivery – Pepsi-Cola has created a program to deliver syrup directly to storage tanks of fountain accounts. This eliminates costly handling of containers.
• Backhaul program – In this program a Pepsi-Cola truck delivers



Stars and Stripes, winner of the America's Cup, raises a Pepsi spinnaker. This type of special event marketing helps generate renewed interest in brand Pepsi, a 90-year-old product. Brand Pepsi retail sales in 1987 totaled $7.7 billion.

its soft drinks, then picks up other goods locally. These are delivered to destinations along its route, earning income from trucks that would otherwise return empty.

Pepsi-Cola Fountain Beverage U.S. Market Share
(Percent)



Pepsi-Cola has achieved a 60% increase in its share of the fountain beverage market since focusing on this segment.

U.S. Soft Drink Distribution Channels

Brand Pepsi is the leading soft drink in supermarkets, the largest distribution channel.

Management's Analysis

(Note: the following discussion should be read in conjunction with "Business Segments" on page 34.)

1987 vs. 1986

Worldwide net sales increased 19%, while operating profits improved 21% over 1986. This growth reflected the positive impact of acquisitions, including MEI Corporation (MEI) and Seven-Up International, and strong sales and operating profit gains in both domestic and international operations.

MEI and Seven-Up International, which have been integrated into the Pepsi-Cola domestic bottling and international operations, respectively, were acquired mid-year 1986. Accordingly, the following discussion focuses on comparisons excluding the estimated impact of these acquisitions on the first half of 1987.

Worldwide net sales improved 12% over 1986. Growth in domestic sales reflected continued volume gains in company-owned bottling operations, which benefited significantly from other smaller acquisitions, as well as growth in concentrate and fountain syrup shipments. Domestic bottlers' case sales (including company-owned and franchised bottlers) increased 6% in 1987, reflecting solid gains in brand Pepsi, Diet Pepsi and Mountain Dew.

International net sales growth

Soft Drinks

was exceptional primarily as a result of increased concentrate shipments, particularly to Venezuela, Northern Europe and Canada, and strengthening foreign currencies. International bottlers' case sales (including company-owned and franchised bottlers) increased 7% in 1987, led by Brazil, the Philippines and Canada.

Worldwide operating profits advanced 13% in 1987. Strong domestic operating profit growth resulted from smaller bottler acquisitions, concentrate volume increases, particularly in Pepsi brands, and reduced pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.)

Excluding unusual gains in 1987 and 1986, international operating profits rose significantly in 1987, primarily reflecting strong volume growth and improved operating margins, partially offset by increased promotional spending. The 1987 results included a $10 million gain resulting from the sale of company-owned bottling operations in Puerto Rico. A $19 million gain was recorded in 1986, reflecting collection of a receivable written off in 1978. Including these gains, international operating profits were about even with the prior year.

1986 vs. 1985

Worldwide net sales and operating profits improved 27% and 23%, respectively, over 1985. Excluding MEI and Seven-Up International, 1986 worldwide net sales and operating profits rose 15% and 14%, respectively, over 1985. The following discussion focuses on comparisons excluding the impact of these acquisitions.

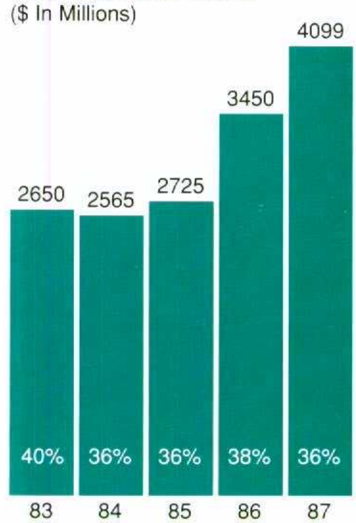
The 1986 domestic net sales improvement reflected continued strong volume gains in company-owned bottling operations, which benefited from other smaller acquisitions, and in concentrate shipments to independent franchised bottlers. Domestic bottlers' case sales increased 7% in 1986, with strong gains in Diet Pepsi, new Slice flavors and fountain syrup sales.

International net sales growth was also strong, reflecting strengthening foreign currencies and increases in concentrate shipments to Canada and the Mediterranean region, partially offset by declines in Venezuela. International bottlers' case sales rose 6% in 1986, led by Brazil, Argentina and the Mediterranean region.

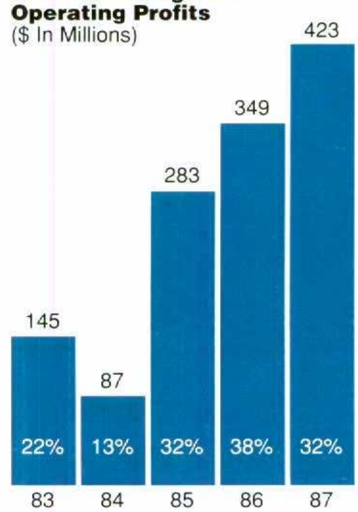
Strong domestic operating profit growth in 1986 resulted from volume gains, which benefited from smaller acquisitions, and improved margins in Pepsi-Cola's company-owned bottling operations.

International operating profits in 1986 reflected the $19 million gain, while results in 1985 included a $26 million credit representing a favorable adjustment to the $156 million charge in 1984 related to the planned sale of several company-owned bottling operations. Excluding these credits in both years, international results were even with 1985, as modest operating gains were offset by a write-off of goodwill.

Soft Drinks Net Sales
% Of Total Net Sales
($ In Millions)



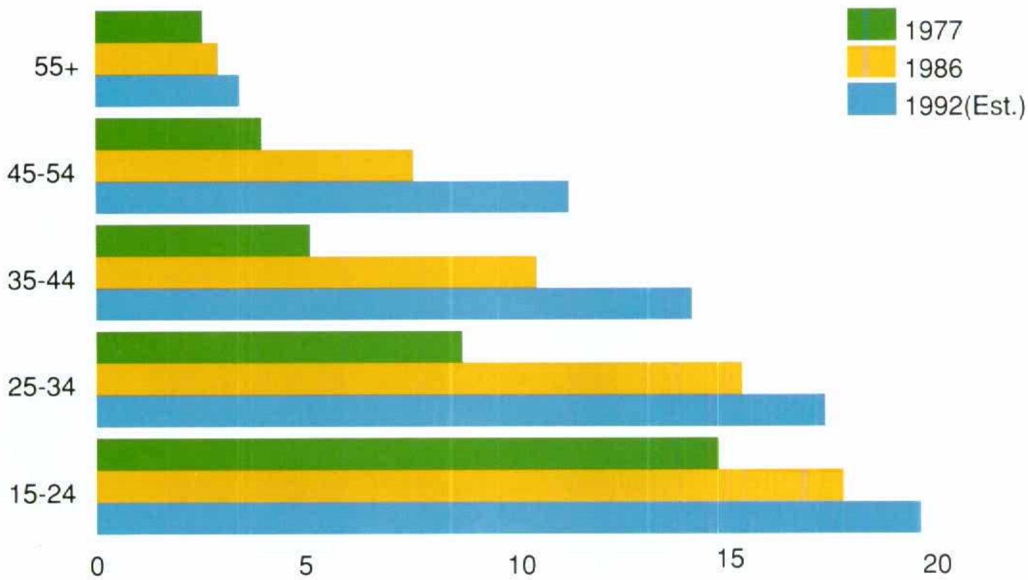
Soft Drinks Operating Profits
% Of Total Segment Operating Profits
($ In Millions)



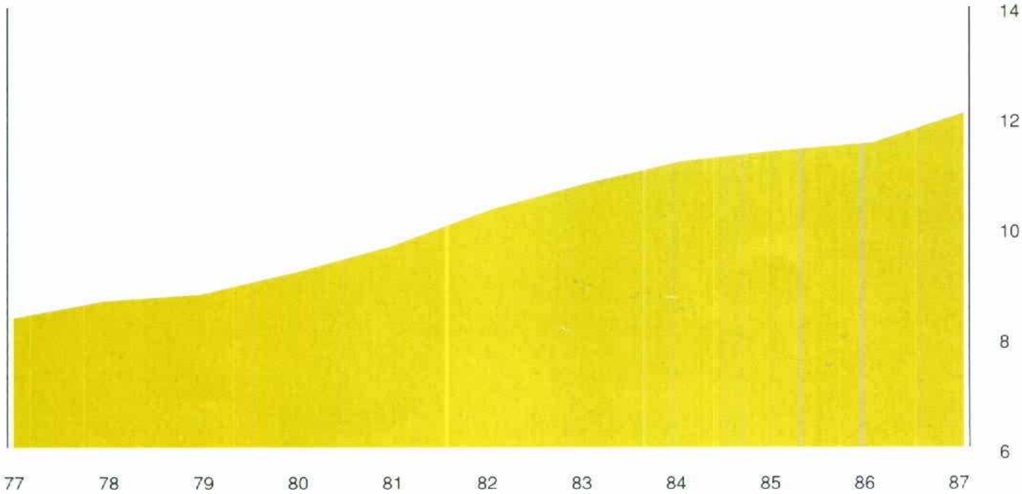
Snack Foods—Today's consumers eat more salty snacks than consumers of the same age a decade ago, and new generations of young people are making snacking a part of their lifestyles.

With total per capita consumption at record levels, the industry outlook is very favorable.

U.S. Salty Snack Consumption By Age Group
(Lbs. Per Capita)



U.S. Salty Snack Consumption
(Lbs. Per Capita)



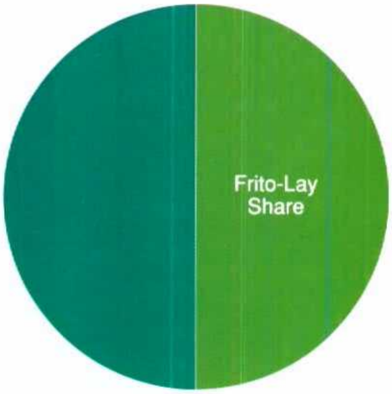
Snack Foods

Snack food sales were up 6%, and operating profits rose 60% (36% excluding unusual items related to discontinued products). It was the 19th consecutive year of sales growth for Frito-Lay, our domestic snack food division and historically our most profitable operating unit.

Industry Perspective

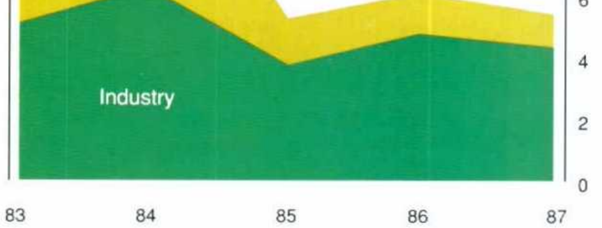
U.S. Snack Food Industry Retail Sales Frito-Lay Share

U.S. Salty Snack Food Industry Retail Sales Frito-Lay Share



U.S. sales of snack foods total $30 billion. Frito-Lay's share of this market is $3.7 billion, about half the salty snack segment.

Frito-Lay Retail Sales vs. All Grocery Products
(% Change)



*Continuing Products

Sales growth of Frito-Lay snacks regularly outpaces the average of all grocery products, and far exceeds it in years when major new products are introduced.

Whether with meals or between meals, snack foods are an integral part of the American diet. Today's adults grew up eating snack foods. And as they mature, they're carrying their consumption patterns with them and fitting snacks into their lifestyles. On an annual basis, today's 40-year-old adult eats approximately four pounds more of salty snacks than his counterpart of a decade ago.

At the same time, today's teenagers – the largest consumers of snack foods – also are eating more snacks than earlier generations of teens. In fact, consumption of salty snacks is rising for all age groups. In 1987 U.S. consumers ate a record 12 pounds of salty snacks per capita.

As in soft drinks, sales of snack foods are growing. As a result, the outlook for the snack business in the United States remains strong.

Similar trends are at work internationally, where we're developing existing markets and entering new ones. Per capita consumption in our current markets varies greatly, but averages 20% of U.S. levels. Given the size of the international market and its low level of development, there's excellent potential for continued growth.

These consumption trends suggest a very favorable outlook for our snack food business and lead to two conclusions:

• By providing consumers with quality snacks in flavors they enjoy, we can sustain growth.

• Because consumers take their habits with them as they grow older, measures we take to expand or stimulate our markets will improve our position, both now and in the future.

Here's a look at our snack food business today, followed by a report on how we're accelerating profitable growth.

Current Position

• U.S. snack food industry retail sales total $30 billion. Frito-Lay's share is $3.7 billion, about half the salty snack segment.

• U.S. per capita consumption of salty snacks over the last five years has grown at a compounded annual rate of about 3%.

• Dollar sales of the average grocery product in the U.S. grew just over 4% last year. Frito-Lay sales of continuing products grew 5%, some 25% faster.

• Total international snack food sales roughly equal the U.S. salty snack market at about $7 billion retail. The PepsiCo Foods International (PFI) system has snack food operations in 17 markets, and accounts for about one-eighth of total retail sales. We are the leading snack food system in half our markets and the second largest in three other markets.

Operating/Distribution Systems

Frito-Lay is the nation's largest manufacturer and marketer of salty snacks. A primary factor in Frito-Lay's success is a complex and highly efficient manufacturing, sales and distribution network.

Some 37 manufacturing plants and 1,600 distribution facilities throughout the country supply fresh products to more than 400,000 accounts. Through a route salesforce numbering over 10,000 persons, Frito-Lay snacks are stocked directly onto supermarket shelves, making the check-out counter the first place supermarket personnel touch Frito-Lay products.

This store-door delivery system ensures freshness and allows Frito-Lay to maintain close inventory control. In addition, by reducing supermarket labor costs, Frito-Lay makes its products among the most profitable dry food brands in the supermarket.

Most salty snacks are sold in supermarkets. Four of Frito-Lay's brands – Doritos brand tortilla chips, Lay's brand and Ruffles brand potato chips and Fritos brand corn chips – are in the top 10 of all dry food brands in U.S. food stores.

Internationally, our snack foods are marketed through company-owned and joint venture operations, as well as through independent licensees.

Accelerating Profitable Growth

Our snack food business has developed several strategies to accelerate profitable growth. Following are five principal strategies, as well as examples of how we execute them.

1. Build brands through line extensions.

• The baby boom generation grew up on Frito-Lay products. As these consumers mature, they continue to enjoy Frito-Lay's brands. At the same time, they're seeking variety and new tastes in snacks.

To capitalize on both trends, Frito-Lay has introduced a number of successful new products as line extensions of existing brands. These new products combine a familiar name with a new taste.

Two examples are Cool Ranch flavor Doritos brand tortilla chips, which achieved retail sales of more than $200 million in 1987, and Cajun Spice flavor Ruffles brand potato chips, a variety that sparked growth of more than 15% for the 30-year-old Ruffles brand.

A major reason for the success of these line extensions is effective marketing. Each flavor variety is treated as a new product, with advertising and promotions designed to focus on the new taste. This strategy achieves two objectives:

• It provides consumers with a growing variety of snacks marketed under a brand name they've known for years.

• It introduces Frito-Lay products to new consumers looking for a unique taste. As a result, sales for the entire brand typically grow.

2. Create a strong regional presence.

• Frito-Lay is increasing its regional marketing staff and programs. The objective is to combine the competitive advantages and economies of scale of a large national company with a strong regional presence. This enables Frito-Lay to respond quickly to local marketing opportunities or competitive actions. For example, by staging promotions tied to special events, such as the "Indy 500" or even the local Soapbox Derby, Frito-Lay is able to more effectively meet local competition.

• Regionalization also can apply to products. For example, Delta Gold brand potato chips are heavily promoted in the Southeast.

3. Meet emerging consumer needs.

• In response to a growing interest in fitness and diet, Frito-Lay was among the first snack food companies to provide nutritional labeling for its products. Now Frito-Lay researchers are seeking ways to offer more product choices that meet consumers' nutritional preferences.

Low-oil products are a new snack concept that offer significant potential. Frito-Lay has begun test marketing Doritos Light brand tortilla chips, a low-oil version of its top-selling Doritos brand tortilla chip. Doritos Light brand offers premium taste with a lower fat content than regular chips. Other low-oil snacks are being tested.

4. Expand internationally through strong partnerships.

As people throughout the world continue to increase their consumption of snack foods, we're rapidly expanding in existing markets and entering new ones. Our partners are among the leading snack food companies in their countries.

Here's a look at our most recent expansion initiatives:

• Canada – PepsiCo and Hostess Food Products Ltd., the snack food division of General Foods Inc., Canada, have announced a

Frito-Lay has begun test marketing Doritos Light tortilla chips, a low-oil version of its top-selling Doritos brand.

joint venture to strengthen and stimulate the Canadian snack food market. The new partnership, called The Hostess Frito-Lay Company, will expand distribution and promotion of our snack foods in this important market.

• Greece – We purchased Tasty Foods, S.A., the country's leading snack food company.

• Portugal – We purchased Laprovar, S.p.a.l., the second leading snack food company.

• Korea – PFI formed Orion Frito-Lay, a joint venture with Tong Yang Confectionary, the second leading snack food company.

• Australia – We added the businesses of Lips Chips, PTY. Ltd., Siesta Food Products, PTY. Ltd. and Red Seal, PTY. Ltd. to our joint venture with Arnott's Snack Foods, the second leading snack food company.

5. **Reap the benefits of global marketing.**

• A major reason PFI is able to expand so rapidly is global marketing, the process of introducing Frito-Lay brands and programs overseas. In 1987, for example, two flavors of Doritos brand tortilla chips were introduced in Japan. Doritos brand tortilla chips were also introduced in Spain and launched nationally in Brazil and Norway.

Improving Productivity

Productivity programs reduce Frito-Lay's costs on a continuing basis and provide additional dollars for accelerating growth. Productivity measures saved more than $150 million just in 1987.

• One example is hand-held computers, now in use in about half of

The Cajun Spice flavor line extension of Ruffles brand potato chips was introduced in Canada.

the Frito-Lay system and scheduled for nationwide rollout. Handheld computers reduce paperwork and keep track of orders. This gives Frito-Lay route salespeople more time to sell. Equally important, the new technology enables Frito-Lay to closely monitor sales of products, immediately evaluate the effect of promotions and adjust delivery accordingly.

• Frito-Lay's Methods Improvement Program asks employees to suggest ways to increase productivity and improve product quality or the work environment. Resulting projects range from adding footrails to production lines to improve safety, to developing new manufacturing ideas.

For example, one employee developed a way to fabricate a machine part in the plant, saving the cost of buying it from an outside supplier. This one parts program saved thousands of dollars in 1987 and was so successful it's being implemented in all Frito-Lay plants. All together, Frito-Lay employees suggested some 14,000 methods to improve operations.

Management's Analysis

(Note: the following discussion should be read in conjunction with "Business Segments" on page 34.)

1987 vs. 1986

Worldwide net sales rose 6%, reflecting solid volume gains both domestically and internationally. The adverse translation impact on international net sales of weakening currencies in Mexico and Brazil was offset by pricing actions in these countries.

Frito-Lay's total pound shipments, excluding discontinued products, advanced 5%, led primarily by line extensions of Doritos brand tortilla chips and Ruffles brand potato chips. PepsiCo Foods International's salty snack unit volume advanced 4%, led by strong gains in Brazil, Spain and Puerto Rico.

Worldwide operating profits advanced 60%, reflecting exceptionally strong performances both domestically and internationally. The significant increase also reflected a $52 million charge recorded by Frito-Lay in 1986 for the discontinuance of certain nonsalty snack products and a reduction of cookie production capacity. In 1987 a $13 million favorable adjustment to the 1986 charge was recorded, primarily reflecting a $10 million gain resulting from the sale of a cookie production facility. Excluding these items, worldwide operating profits increased 36%.

Frito-Lay's impressive operating profit improvement also reflected strong growth in core brand salty snack volume and related productivity gains, lower ingredient costs and reduced pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.) In addition, 1986 operating profits were depressed by expenses associated with the introduction of new nonsalty snack products, which were subsequently discontinued.

Internationally, operating profits rose significantly, reflecting volume growth in Spain, improved operating margins in Canada, Spain and Puerto Rico, and small acquisitions.

1986 vs. 1985

Worldwide net sales rose 6%, reflecting solid volume gains both domestically and internationally. Frito-Lay's total pound shipments,

excluding discontinued products, advanced 4%, led primarily by core brand line extensions and new products.

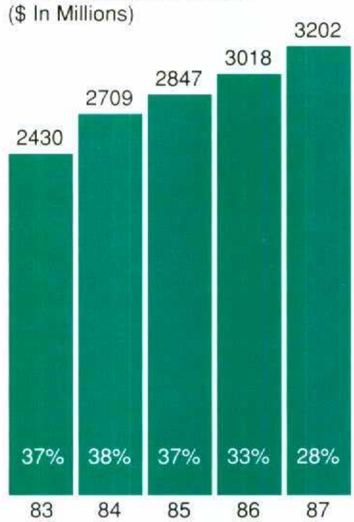
PepsiCo Foods International's salty snack unit volume gained 6%, with modest growth in Mexico and strong gains in Brazil and Spain.

The $52 million charge in 1986 and a $16 million charge in 1985, which related to the discontinuance of cookies in the large-sized package, reflected strategic decisions to streamline Frito-Lay's product lines. As a result, worldwide snack foods operating profits declined 13% in 1986 including these charges and 3% excluding these charges. Domestically, Frito-Lay's operating profits excluding these charges also declined slightly compared to 1985.

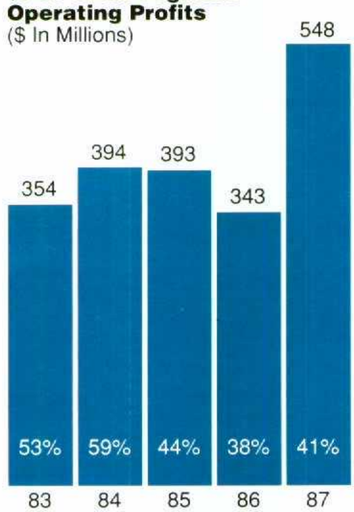
Frito-Lay's results reflected volume gains and moderate pricing, which were more than offset by higher selling costs associated with major investment spending programs to support new product and selling strategies.

International operating profits also decreased from a strong 1985, primarily reflecting higher promotional spending in Canada and the adverse translation impact of the weakening Mexican peso.

Snack Foods Net Sales
% Of Total Net Sales
($ In Millions)



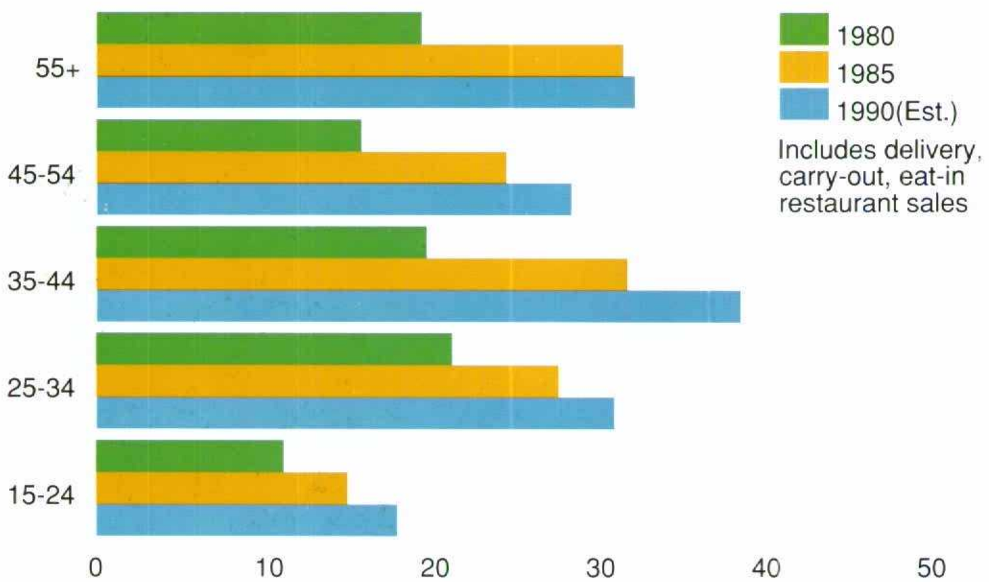
Snack Foods Operating Profits
% Of Total Segment Operating Profits
($ In Millions)



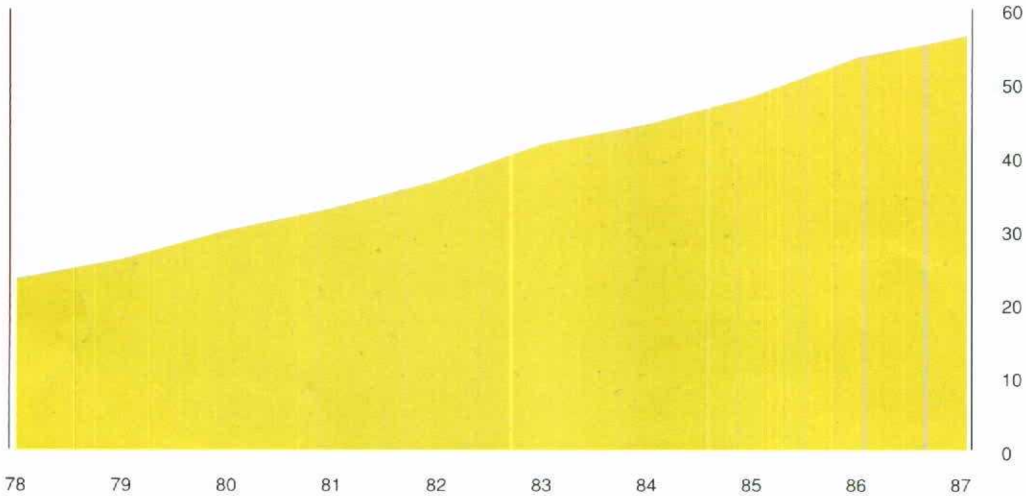
Restaurants—The current generation of consumers is eating-out, ordering-in or taking-out their meals at record rates.

As lifestyles change and Americans spend more of their dollars on food prepared away from home, quick service restaurant sales continue to climb.

U.S. Purchases of Food Away From Home By Age Group
($ In Billions)



U.S. Quick Service Restaurant Sales
($ In Millions)



Restaurants

Restaurant profits climbed 57% on a 58% increase in sales. Each of our three major restaurant divisions achieved profit gains and continued to lead its category.

Industry Perspective

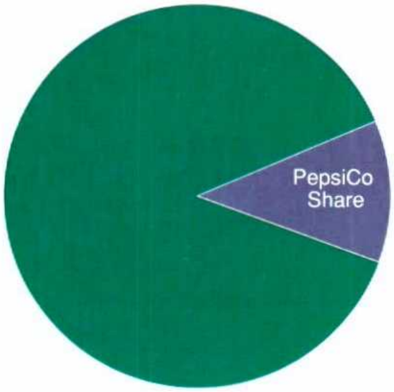
Today's adults are the first generation to make quick service restaurants, carry-out foods and home-delivered meals a routine part of their lives. As these consumers grow older, they continue to eat-out, take-out and order-in at record levels. More significantly, their children, in turn, are growing up on the convenience of foods prepared away from home. And they're making these eating habits an even stronger part of their own lifestyles.

Americans now purchase one out of every three meals away from home. And they spend more than 40% of their food dollars on foods prepared away from home, compared to 26% in 1960.

The interest in foods prepared away from home is accelerating as lifestyles change and people continue to seek greater convenience. Trends that are fueling restaurant growth include the rise in the number of families with both parents working, single parent families and single person households. Growth is expected to accelerate in the future as today's youngsters grow up, allowing their parents to spend more on dining out.

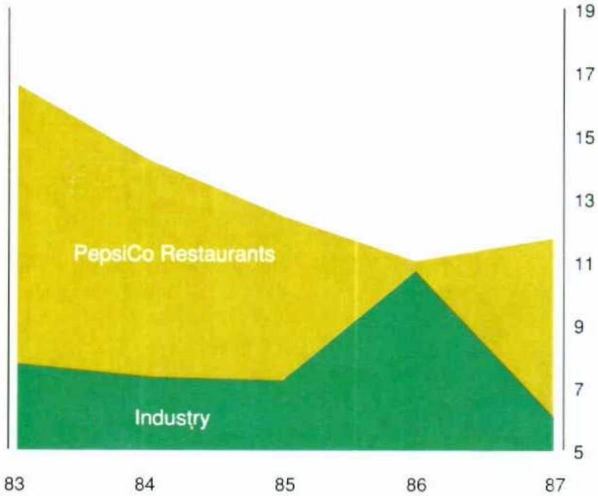
The international restaurant market has the potential to be significantly larger than the U.S. market, and similar demographic trends are at work. Yet the quick service restaurant industry is

U.S. Quick Service Restaurant Industry Retail Sales PepsiCo Share



U.S. quick service restaurant sales total $56 billion. PepsiCo's restaurant systems account for sales of $6.7 billion.

PepsiCo U.S. Restaurant Systems vs. U.S. Industry Sales Growth
(% Change)



PepsiCo's restaurant system sales grew almost twice as fast as the industry in 1987. A variety of new products introduced several years ago, including Personal Pan Pizza and Taco Salad, continue to generate sales.

only beginning to develop in many countries.

PepsiCo's restaurant systems are in an excellent position to take advantage of this market potential. We are sustaining our growth by meeting consumer desires for quality, convenience, service and value. By taking action to stimulate our markets and expand our worldwide systems, we can accelerate that growth.

Here's a look at our restaurant business today, followed by a report on how we plan to achieve continued growth.

Current Position

• U.S. restaurant industry sales are estimated at $129 billion in 1987. Sales in the quick service segment of the industry are nearly $56 billion – up from $20 billion in 1977. The PepsiCo system's share of the U.S. market is $6.7 billion.
• Mexican food, pizza and chicken are the fastest-growing and among the largest restaurant categories in the United States.
• Our restaurant divisions continue to outperform the industry. Since 1982 system sales at U.S. quick service restaurants have grown at about an average rate of 8%. PepsiCo's restaurant system sales grew nearly 70% faster than the industry rate.
• In international markets the quick service segment is underdeveloped. PepsiCo is among the first to enter this relatively untapped yet high-potential market.

Operating Systems

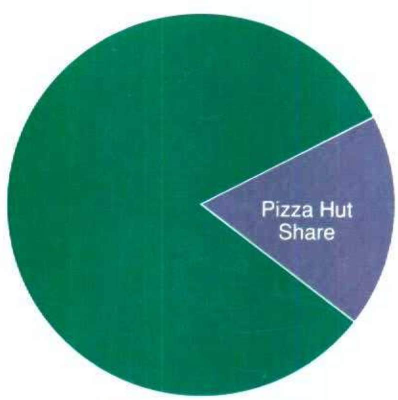
PepsiCo has the largest restaurant system in the world – nearly 16,500 units.

Our system of franchised, joint

U.S. Chicken Restaurant Market

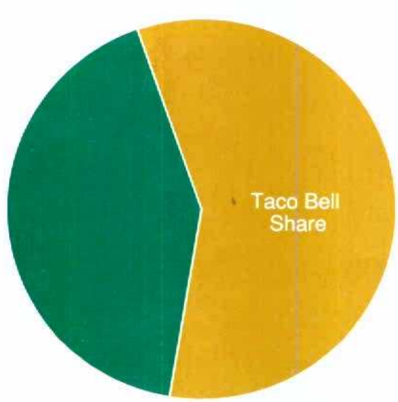
Kentucky Fried Chicken has the leading share of the $6 billion quick service chicken restaurant market. KFC's 1987 systemwide sales in the United States totaled $2.7 billion.

U.S. Pizza Restaurant Market



Pizza Hut is the market leader in the U.S. pizza category, with systemwide sales of $2.5 billion. Total industry sales in 1987 were $13 billion.

U.S. Mexican Restaurant Market



The U.S. Mexican restaurant category has sales of $2.6 billion. Taco Bell is the leader in this market, with systemwide sales of $1.5 billion.

Restaurant Unit Growth

Number of Units Worldwide (Year-end 1982-1987)

Year	KFC	Pizza Hut	Taco Bell	PFSI	Total
1982	5,779	3,820	1,489	284	11,372
1983	5,971	3,996	1,663	334	11,964
1984	6,175	4,208	1,833	404	12,620
1985	6,396	4,482	2,173	518	13,569
1986	6,575	5,017	2,409	663	14,664
1987	7,522	5,394	2,696	858	16,470
Five-Year Compounded Annual Growth Rate	5.4%	7.1%	12.6%	24.7%	7.7%

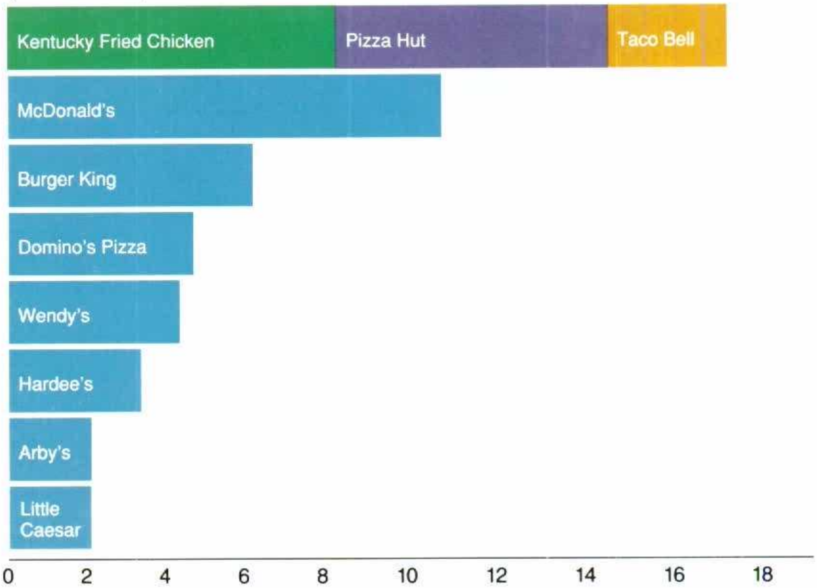
Totals include KFC, acquired October 1, 1986, as though it were part of PepsiCo since 1982.

Number of Units Worldwide (Year-end 1987)

	KFC	Pizza Hut	Taco Bell	Total
United States				
Company	1,250	2,654	1,476	5,380
Franchise	3,564	2,740	1,220	7,524
International				
Company	276	189	24	489
Joint Venture	375	188	–	563
Franchise	2,057	439	18	2,514
Total	7,522	6,210	2,738	16,470

PepsiCo is adding more than 1,000 new units a year. That's bigger than most restaurant chains in the world. In other words, we've added the equivalent of a new restaurant chain each year.

Restaurant Units
Top 10 Chains
(In Thousands)



The combined units of Kentucky Fried Chicken, Pizza Hut and Taco Bell make PepsiCo the largest restaurant system in the world.

venture and company-owned restaurants combines the resources, competitive advantages and economies of scale of a large multinational company with the local market strengths and entrepreneurial drive of independent businesspeople.

As restaurant owners and operators, we share with our franchisees an understanding of the marketplace. And we also share the risks and rewards of the restaurant business. At the same time, owning our own restaurants gives us the ability to quickly test new products and innovative procedures.

Following is a look at each of our restaurant divisions:

• Kentucky Fried Chicken (KFC) is our largest restaurant operation and the world's largest quick service chicken restaurant system. Worldwide KFC system sales totaled $4.1 billion in 1987. In the $6 billion U.S. quick service chicken category, the KFC system has sales of $2.7 billion – about 45% of the market.

Outside the United States, KFC units are located in 56 countries and have system sales of $1.4 billion.

• Pizza Hut – In the $13 billion U.S. pizza category, Pizza Hut is the leading pizza restaurant chain. In 1987 the Pizza Hut system had sales of $2.5 billion, nearly one-fifth of the total market.

• Taco Bell – In the $2.6 billion U.S. quick service Mexican category, Taco Bell is the leading Mexican restaurant chain. With system sales of $1.5 billion, it accounts for more than half of this quick service category.

• PepsiCo Food Service International (PFSI) is responsible for Pizza Hut and Taco Bell operations outside the United States. PFSI operates in 46 markets.

Taco Bell is only beginning to expand overseas, but Pizza Hut is the leading quick service pizza chain in most of PFSI's markets.

Accelerating Profitable Growth

We've developed several strategies that build on our strong position in the food service business. Following are four of these strategies and examples of how we are implementing them to accelerate profitable growth in each of our restaurant divisions.

1. Open market segments with new products.

• The biggest new KFC product is Chicken Littles chicken sandwiches. Consumers have typically visited KFC for dinner. Now these one-ounce chicken patties on a bun also are making KFC a place for lunch or a snack. Chicken Littles are priced low and are convenient to eat, so they appeal to a wide range of consumers. The new sandwiches also increase sales of soft drinks and french fries, two very profitable items. With Chicken Littles as a base, KFC is expanding its lunchtime business.

• Hand Tossed Traditional Pizza is now in test at Pizza Hut. Pizza Hut is adding this new product to meet the preferences of the one-third of consumers who want a pizza crust somewhere between Pizza Hut's best-selling Pan Pizza and Thin 'N Crispy. Hand Tossed Traditional Pizza will help Pizza Hut fulfill its mission of consistently demonstrating it's the best choice for every pizza occasion.

• Steak Fajitas, a traditional Mexican steak sandwich, has done

Restaurant Sales Growth

Average Domestic Unit Sales ($ Thousands)
Combined Company and Franchise

	1982	1983	1984	1985	1986	1987	5 Yr. % Growth
KFC	388	431	459	502	529	558	7.5
PH	351	412	435	457	468	490	6.9
TB	390	436	539	550	560	579	8.2

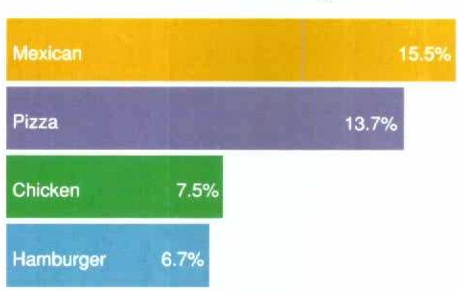
Domestic and International Systemwide Sales ($ Billions)

	1982	1983	1984	1985	1986	1987	5 Yr. % Growth
KFC	2.4	2.6	2.9	3.1	3.5	4.1	11.3
PH	1.3	1.6	1.8	2.0	2.2	2.5	14.0
TB	.6	.7	.9	1.1	1.3	1.5	20.1
PFSI	.09	.11	.15	.24	.33	.44	37.4
Total	4.39	5.01	5.75	6.44	7.33	8.54	14.2

Totals include KFC, acquired October 1, 1986, as though it were part of PepsiCo since 1982.

Average domestic unit sales in the PepsiCo system have consistently grown faster than the industry. PepsiCo systemwide restaurant sales exceeded $8 billion in 1987.

Fastest-Growing U.S. Restaurant Categories



(Compounded annual sales growth rate 1982-87)

PepsiCo's restaurants are the leaders in three of the largest and fastest-growing restaurant categories.

more for Taco Bell than bring in new consumers. With the addition of a grill to existing kitchen equipment, Steak Fajitas has opened up a range of new product possibilities. Other fajitas products are already being tested.

2. Fully develop our distribution channels.

To successfully expand our markets, we're providing consumers with the service and convenience they demand. Here are some actions our restaurant systems have taken:

• More than three-fourths of KFC's sales are take-out. To make service even more convenient, KFC is continuing to add drive-thru windows. At the same time, to attract more consumers who prefer to dine-in, KFC is continuing to refurbish existing restaurants and provide additional seating.

• Delivery is a fast-growing segment of the pizza market. Pizza Hut aggressively entered this market in 1985. In the second half of 1987 performance reached the break-even point, and we expect delivery to be profitable in 1988. We now have delivery operations in 36 states, and our plans call for further expansion.

• The on-the-go market represents another opportunity that Pizza Hut is pursuing. Counter service is being tested at major shopping areas.

• In PFSI's markets "pizza by the slice" is a new concept being tested. Delivery, another popular U.S. concept, is being introduced in several countries.

3. Fit our menus to today's lifestyles.

Here are some examples of how our restaurant divisions are fitting their menus to today's lifestyles.

• People are increasing their consumption of chicken. To increase its market share and attract those customers who want an alternative to fried chicken, KFC is developing nonfried chicken meals. These are in test in several markets.

• Pizza Hut is adding variety and interest to its menu with promotional pizzas. These are pizza specialties, such as Cheese Lovers Pizza, Meat Lovers Pizza and Cajun Style Pizza. Each is available for a limited period and creates new promotional opportunities for Pizza Hut.

• Taco Bell is testing a line of "finger foods," menu items that are convenient to hold and easy to eat on the run. These products are expected to expand Taco Bell's carry-out and drive-thru business.

Taco Bell also expanded its menu with Soft Taco and Soft Taco Supreme.

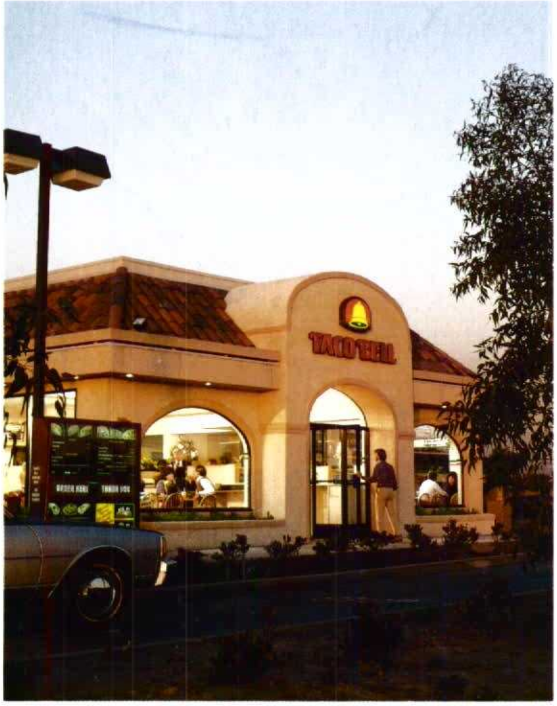
4. Grow by acquisitions and geographic expansion.

We're continuing to add restaurants to our system at a rapid rate. The chart on page 28 summarizes our restaurant unit growth. Following are some additional highlights:

• In August PepsiCo acquired Kentucky Fried Chicken of Canada, adding 759 franchised restaurants to our worldwide KFC system.

• In November KFC became the first quick service restaurant to open in the People's Republic of China. The 500-seat restaurant is the largest quick service restaurant in the world. The quick service food industry is only beginning to develop in China.

Kentucky Fried Chicken opened the world's largest quick service restaurant in Beijing, People's Republic of China.



Taco Bell is expanding its drive-thru and carry-out business.

With our joint venture partners, the Beijing Corp. of Animal Production, Processing, Industry and Commerce and the Beijing Travel and Tourism Corp., we see considerable long-term potential for the restaurant business in China.

• Among the new restaurants Pizza Hut added to its system were approximately 100 units acquired from another restaurant system and converted to Pizza Hut restaurants. This increases the number of Pizza Hut restaurants without adding new units to the industry. Taco Bell also grows this way.

• PFSI added 10 new countries to its markets – the most new countries in any one year. Negotiations for the opening of Pizza Hut and Taco Bell restaurants in several other countries are in progress.

Improving Productivity

As in our soft drink and snack food businesses, productivity measures continue to improve performance at our restaurant divisions. Following are a few examples:

• At KFC the introduction of computer-controlled fryers will ensure quality while reducing costs. Since the computer controllers cook at an even temperature, there's less waste of product and oil. The process controllers also reduce labor needs by eliminating hours spent monitoring cooking.

• Among the programs in test at Pizza Hut are ovens that significantly reduce cooking time and order entry systems that allow waiters and waitresses to use small hand-held terminals to send orders directly to the kitchen. The results include faster service and more accurate ordering.

• New management systems are reducing costs and improving service at Taco Bell restaurants. Under the system, employee work schedules can be developed to more closely conform to customer traffic patterns.

Management's Analysis

(Note: the following discussion should be read in conjunction with "Business Segments" on page 34.)

1987 vs. 1986

Worldwide net sales increased 58%, while operating profits improved 57% over 1986. These gains reflected the positive impact of Kentucky Fried Chicken's (KFC) operations, reduced losses related to Pizza Hut delivery operations and volume increases at Taco Bell.

For the full year, KFC posted a 6% increase over 1986 in average sales per domestic company-owned restaurant, and significant growth in profits fueled by international operating gains. Because KFC was acquired in October 1986, the following discussion focuses on comparisons excluding the impact of KFC's operations.

Worldwide net sales advanced 17% over 1986, due primarily to the addition of new restaurants and pizza delivery units and volume increases. Aggressive promotional programs and significant gains in average sales per delivery unit contributed to Pizza Hut's growth. Taco Bell's sales were also aided by pricing actions and new products, such as the soft shell taco and Steak Fajitas, introduced in the first half of the year. Combined average sales per domestic company-owned Pizza Hut and Taco Bell restaurant rose 4% for the year. International sales improved significantly as a result of new unit development and strengthening foreign currencies.

Worldwide operating profits rose 12% due to improved Pizza Hut delivery operations, a gain resulting from the sale of a number of company-owned restaurants in Australia and reduced domestic pension expense resulting from the required adoption of new pension accounting rules. (See Note to Consolidated Financial Statements on page 47.)

Domestically, Pizza Hut's strong operating profit advances reflected significantly reduced delivery losses, partially offset by higher promotional spending and lower gains resulting from sales of company-owned restaurants. Taco Bell's operating profits rose as a result of increased volumes and higher gains resulting from sales of company-owned restaurants, partially offset by higher cost of sales and increased occupancy expenses. The increase in cost of sales, mitigated by pricing actions, reflected the higher cost of ingredients and Steak Fajitas. Gains resulting from the sales of company-owned Pizza Hut and Taco Bell restaurants represented 8% of domestic operating profits in 1987 and 1986.

Significantly increased international operating profits reflected the gain resulting from the sale of company-owned restaurants in Australia. Excluding this gain, operating profits were down from a small base in 1986, reflecting start-up losses associated with significant growth in new restaurants and delivery units.

1986 vs. 1985

Worldwide net sales increased 29%, and operating profits improved 5% over 1985. Exclud-

ng KFC, worldwide net sales dvanced 15%, while operating rofits declined 4%. The following iscussion focuses on comparisons xcluding the impact of KFC.

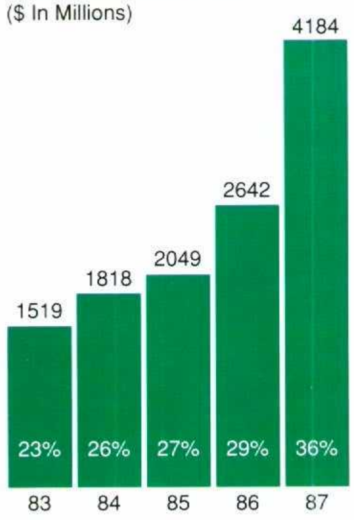
The significant growth in net ales was due primarily to the ddition of new restaurants nd pizza delivery units. For he year, combined average sales er domestic company-owned izza Hut and Taco Bell restau- ant rose 1%. Strong international et sales in 1986 reflected higher olumes in Australia and Canada.

The decline in 1986 worldwide perating profits primarily re- lected increased start-up losses elated to Pizza Hut delivery perations, partially offset by an mprovement in other restaurant perations and higher gains esulting from the sales of ompany-owned restaurants.

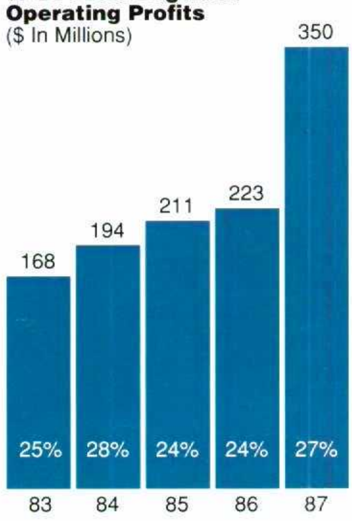
Domestically, operating profits t Pizza Hut were down slightly rom 1985, with gains from vol- me increases and lower food osts offset by higher home deliv- ry losses. Taco Bell's operating rofits were up due to strong vol- me gains and lower food costs, artially offset by higher expenses esulting from more units and mprovements to existing units. Gains resulting from the sales of ompany-owned Pizza Hut and aco Bell restaurants repre- ented 8% and 5% of domestic perating profits in 1986 and 985, respectively.

International operating profits vere down, reflecting increased romotional and new market levelopment costs.

Restaurants Net Sales
% of Total Net Sales
($ In Millions)



Restaurants Operating Profits
% Of Total Segment Operating Profits
($ In Millions)



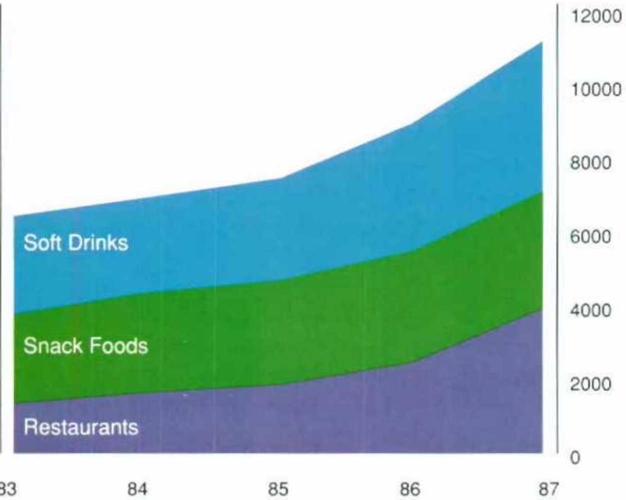
Financial Review

Contents

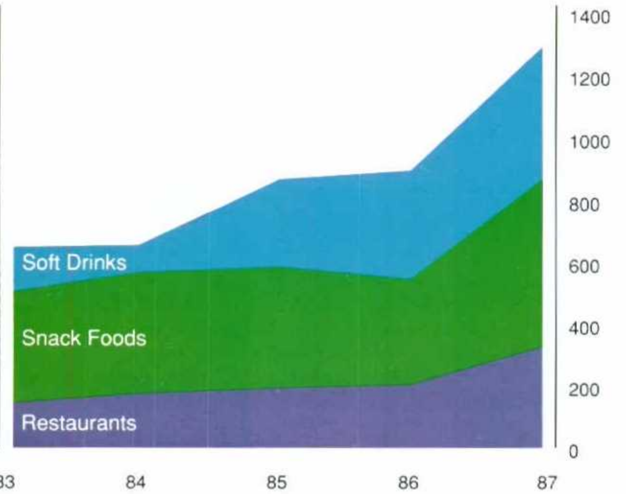
Business Segments

This information constitutes a Note to the Consolidated Financial Statements.

Net Sales
($ In Millions)



Operating Profits
($ In Millions)



PepsiCo operates on a worldwide basis within three distinct business segments: soft drinks, snack foods and restaurants. Management's discussion and analysis of PepsiCo's business segments are on pages 14, 22 and 31 under the caption "Management's Analysis."

The soft drinks segment primarily manufactures and markets Pepsi-Cola, Slice and their allied brands worldwide and 7UP internationally. For purposes of this Note, the operations of the soft drink concentrate manufacturing facilities in Puerto Rico are allocated between domestic and foreign based upon the actual concentrate shipments to the respective markets. The snack foods segment primarily manufactures and markets salty snacks. The restaurants segment includes the operations of Pizza Hut, Taco Bell and Kentucky Fried Chicken. The soft drinks and restaurants segment data include the operations of the soft drink bottling business of MEI Corporation, the international franchise soft drink business of The Seven-Up Company and Kentucky Fried Chicken operations from their respective dates of acquisition in 1986. (See Note to Consolidated Financial Statements on page 43.)

	1987	1986	1985
Net Sales:			
Soft drinks	**$ 4,099.4**	$3,450.0	$2,725.1
Snack foods	**3,202.0**	3,018.4	2,847.1
Restaurants	**4,183.8**	2,641.5	2,049.3
Total continuing operations	**$11,485.2**	$9,109.9	$7,621.5
Foreign portion	**$ 1,969.6**	$1,225.8	$ 951.9
Income from Continuing Operations Before Income Taxes:			
Operating profits			
Soft drinks	**$ 423.2**	$ 348.6	$ 283.4(b)
Snack foods	**547.6(a)**	342.8(a)	392.5
Restaurants	**349.9**	222.5	211.3
	1,320.7	913.9	887.2
Corporate expenses, net	**(360.3)**	(221.1)	(202.4)
Total continuing operations	**$ 960.4**	$ 692.8	$ 684.8
Foreign portion of operating profits	**$ 143.4**	$ 64.7	$ 70.0(b)
Capital Spending:			
Soft drinks	**$ 202.0**	$ 193.9	$ 160.7
Snack foods	**195.6**	298.6	286.3
Restaurants	**370.8**	380.5	315.4
Corporate	**6.6**	9.2	7.9
Total continuing operations	**$ 775.0**	$ 882.2	$ 770.3
Foreign portion	**$ 145.1**	$ 81.4	$ 67.3

Operating profits included research and development expenses of $83 million, $82 million and $66 million in 1987, 1986 and 1985, respectively.

The effect of adopting Financial Accounting Standard No. 87 on Employers' Accounting for Pensions was to reduce 1987 pension expense of soft drinks, snack foods, restaurants and corporate by $14 million, $25 million, $8 million and $3 million, respectively. (See Note to Consolidated Financial Statements on page 47.)

Corporate expenses included unallocated corporate items, interest expense, unallocated interest income and net foreign exchange gains. Unallocated interest income was $90 million, $100 million and $77 million, and foreign exchange gains were $2 million, $33 million and $32 million in 1987, 1986 and 1985, respectively. The foreign exchange gains in 1986 and 1985 arose principally from the translation of foreign local currency borrowings.

Corporate identifiable assets principally consisted of offshore short-term investments, which are included in the foreign portion. Included in 1985 was the receivable from the sale of North American Van Lines and the investment in Safe Harbor leases.

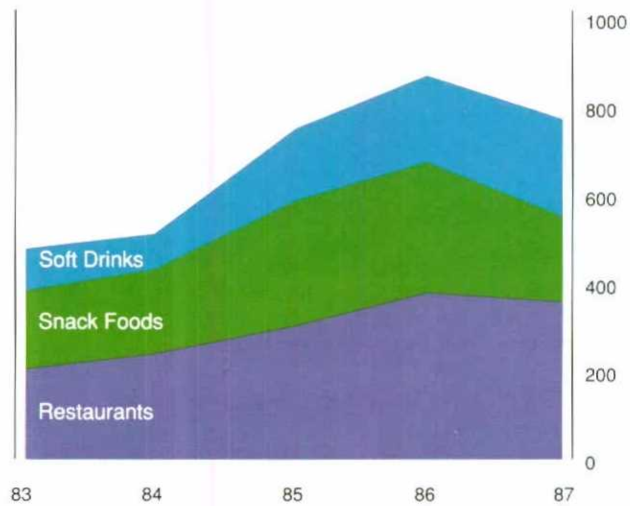
	1987	1986	1985
Identifiable Assets:			
Soft drinks	**$ 2,779.8**	$2,615.9	$1,329.1
Snack foods	**1,632.5**	1,596.3	1,480.3
Restaurants	**2,782.9**	2,563.1	1,266.0
Corporate	**1,827.5**	1,251.8	1,813.9
Total continuing operations	**$ 9,022.7**	$8,027.1	$5,889.3
Foreign portion	**$ 2,993.8**	$2,296.2	$1,071.5
Depreciation and Amortization Expense:			
Soft drinks	**$ 166.5**	$ 104.3	$ 69.2
Snack foods	**154.1**	135.3	107.7
Restaurants	**237.1**	151.8	104.6
Corporate	**5.3**	4.7	4.7
Total continuing operations	**$ 563.0**	$ 396.1	$ 286.2
Foreign portion	**$ 75.8**	$ 36.3	$ 25.3

The 1986 and 1985 amounts have been restated to reflect the divestiture of La Petite Boulangerie and certain other reclassifications to conform to the 1987 presentation.

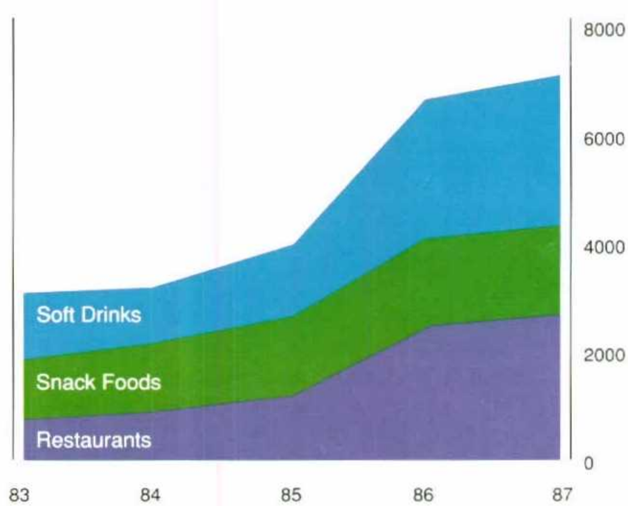
(a) In 1986 a $52.0 million charge was recorded by Frito-Lay for discontinuance of certain nonsalty snack products and reduction of cookie production capacity. In 1987 a $12.5 million favorable adjustment to the 1986 charge was recorded, primarily reflecting a $10.0 million gain resulting from the sale of a cookie production facility.

(b) In 1985 a $25.9 million credit was recorded as an adjustment to a 1984 charge related to the planned sale of several company-owned foreign bottling operations.

Capital Spending
($ In Millions)



Identifiable Assets
($ In Millions)



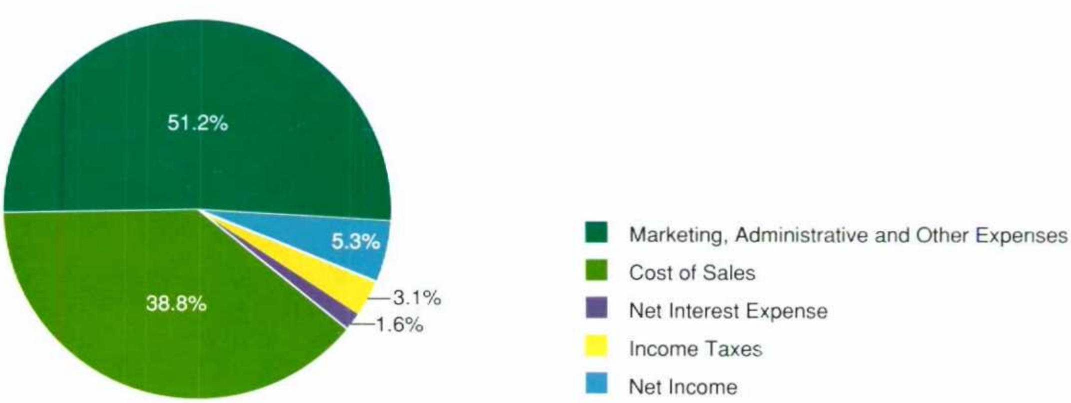
Consolidated Statement of Income

(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 26, 1987, December 27, 1986 and December 28, 1985

	1987	1986	1985
Net Sales	$11,485.2	$9,109.9	$7,621.5
Costs and Expenses			
Cost of sales	4,459.2	3,718.8	3,137.7
Marketing, administrative and other expenses	5,882.7	4,558.1	3,700.2
Interest expense	296.8	263.1	195.2
Interest income	(113.9)	(122.9)	(96.4)
	10,524.8	8,417.1	6,936.7
Income from Continuing Operations Before Income Taxes	960.4	692.8	684.8
Provision for Income Taxes	355.3	229.0	258.2
Income from Continuing Operations	605.1	463.8	426.6
Discontinued Operations			
(Loss) income from discontinued operations (net of income tax benefit of $1.3 and $6.5 in 1987 and 1986 and $0 tax effect in 1985)	(1.3)	(6.0)	3.1
(Loss) gain on disposals (net of income tax benefit of $6.9 in 1987 and provision of $28.8 in 1985)	(9.0)	–	114.0
	(10.3)	(6.0)	117.1
Net Income	$ 594.8	$ 457.8	$ 543.7
Income (Loss) Per Share			
Continuing operations	$2.30	$1.77	$1.53
Discontinued operations	(0.04)	(0.02)	0.41
Net Income Per Share	$2.26	$1.75	$1.94
Average shares outstanding used to calculate income (loss) per share	263.1	262.2	280.7

See accompanying Notes to Consolidated Financial Statements.

Allocation of 1987 Net Sales



Management's Analysis—Results of Continuing Operations

The 1986 acquisitions of Kentucky Fried Chicken (KFC), MEI Corporation (MEI) and Seven-Up International (the Acquisitions) significantly impacted net sales, costs and expenses and income from continuing operations in both 1987 and 1986. Because MEI and Seven-Up International were acquired mid-year 1986 and KFC was acquired in the fourth quarter of 1986, the following analysis discusses financial results both including and excluding the impact of the Acquisitions where the difference is significant. For purposes of the latter discussion, comparisons of 1987 to 1986 exclude the estimated first half 1987 impact of MEI and Seven-Up International, while the full impact of KFC is excluded from both years. The comparisons of 1986 to 1985 exclude the full impact of the Acquisitions on 1986 results.

Net Sales, Costs and Expenses

Net sales advanced 26% in 1987, compared to a 20% increase in 1986. Excluding the Acquisitions, the 1987 and 1986 increases were 11% and 12%, respectively, reflecting solid volume gains in soft drink operations, increases in new restaurant and pizza delivery units and the success of Frito-Lay's core brand line extension strategy. Results in 1987 and 1986 also benefited from other smaller acquisitions of domestic franchised bottlers.

Cost of sales as a percent of net sales continued to decline from 41.2% in 1985 to 40.8% in 1986 and 38.8% in 1987. The 1987 and 1986 decreases were primarily attributable to the growth of the higher gross margin restaurant segment, which reflected the impact of KFC, and improved gross margins at Frito-Lay.

Marketing, administrative and other expenses rose 29% in 1987, compared to a 23% increase in 1986. The 1987 increase excluding the Acquisitions was 13%, reflecting higher selling costs associated with new restaurants and pizza delivery units, increased promotional spending particularly in soft drinks and restaurants and the impact of smaller bottler acquisitions. Also negatively impacting these costs was a reduction in net foreign exchange gains of $31 million, resulting primarily from lower 1987 local currency debt levels in Brazil and Mexico.

The 1986 increase in marketing, administrative and other expenses excluding the Acquisitions was 15%, reflecting higher selling expenses primarily associated with Frito-Lay's new products and costs related to new restaurants and pizza delivery units.

In 1987 and 1986 there were several unusual items which collectively did not have a significant impact on the 1987 and 1986 rates of increase in marketing, administrative and other expenses. Results in 1987 reflected $18 million in gains resulting from the sales of bottling operations in Puerto Rico and certain restaurants in Australia, and a $13 million favorable adjustment to a 1986 Frito-Lay charge, primarily reflecting a gain resulting from the sale of a cookie production facility. A $52 million charge was recorded by Frito-Lay in 1986 for the discontinuance of certain new nonsalty snack products and a reduction in cookie production capacity. Also recorded in 1986 was a $22 million gain arising from the favorable impact of the U.S. Tax Reform Act of 1986 (TRA) on PepsiCo's Safe Harbor leases (the Leases).

Also reflected in cost of sales and marketing, administrative and other expenses in 1987 was a benefit of $50 million or $28 million after-tax ($0.11 per share) resulting from the required adoption of Financial Accounting Standard No. 87, Employers' Accounting for Pensions (SFAS 87). (See Note to Consolidated Financial Statements on page 47.)

Interest expense increased 13% in 1987, following a 35% rise in 1986. The 1987 increase reflects the full-year effect of financing the Acquisitions moderated by declines in the amount of foreign borrowings and domestic and foreign interest rates. The significant rise in 1986 was primarily due to higher domestic debt used to finance the Acquisitions and the 1985 and 1986 share repurchases, partially offset by lower domestic and foreign interest rates. Excluding the Acquisitions for the full year, interest expense would have been an estimated $170 million and $209 million for 1987 and 1986, respectively.

Interest income declined 7% in 1987, following a 27% increase in 1986. The 1987 decrease reflected lower average levels of short-term investments, lower interest rates and the effect of the 1986 collection of $11 million in interest on a foreign receivable previously written off. The increase in 1986 also reflected higher average levels of short-term investments.

Income from Continuing Operations Before Income Taxes

Income from continuing operations before income taxes increased 39% in 1987, compared to 1% in 1986. Excluding the Acquisitions, the 1987 increase was approximately 33% reflecting strong profit advances in all three business segments, led by significant operating improvements at Frito-Lay. Results also benefited from the adoption of SFAS 87 and the gains resulting from asset sales previously described. The 1986 improvement excluding the Acquisitions was 3%, which benefited from strong profit advances in the soft drinks segment, the gain related to the Leases and a $19 million gain (including interest income of $11 million) from the collection of a foreign receivable, partially offset by the Frito-Lay charge.

Provision for Income Taxes

The effective tax rates on income from continuing operations were 37%, 33% and 38% in 1987, 1986 and 1985, respectively. The effective tax rate in 1986 benefited from an $18 million reversal of previously provided deferred foreign taxes, reflecting management's decision to indefinitely reinvest certain unremitted prior years' foreign earnings, and the nontaxable $22 million gain arising from the favorable impact of the TRA on the Leases. The higher effective tax rate for 1987 reflects the absence of these one-time 1986 benefits and higher state income taxes, partially offset by the impact of the lower federal statutory tax rate provided by the TRA. The benefit of the TRA on the 1987 provision was approximately $30 million or a 3 percentage point reduction in the effective tax rate. The effective tax rate was not materially affected by the Acquisitions.

New rules for accounting for income taxes, issued in late 1987, may have a favorable impact on income in 1988 or 1989. (See Note to Consolidated Financial Statements on page 46.)

Income Per Share from Continuing Operations

Income per share from continuing operations increased 30% to $2.30 in 1987, compared to a 16% increase in 1986 to $1.77. The unusual items in 1987 and 1986 identified above, including the impact of SFAS 87, had an insignificant impact on the 1987 rate of growth in income per share. For the full year, the Acquisitions contributed an estimated $0.13 to 1987 income per share (after related interest expense) compared to a $0.05 reduction in 1986. Share repurchases provided an estimated $0.07 incremental benefit to 1986 results.

Consolidated Statement of Financial Condition

(in millions except per share amount)
PepsiCo, Inc. and Subsidiaries
December 26, 1987 and December 27, 1986

	1987	1986
Assets		
Current Assets		
Cash	$ 41.8	$ 34.8
Short-term investments, at cost which approximates market	1,310.8	885.6
	1,352.6	920.4
Notes and accounts receivable, less allowance: $55.4 in 1987 and $43.1 in 1986	885.6	818.7
Inventories	433.0	429.9
Prepaid expenses, taxes and other current assets	268.4	358.1
	2,939.6	2,527.1
Long-term Receivables, Investments and Other Assets	581.4	397.8
Property, Plant and Equipment	4,117.4	3,817.6
Goodwill and Other Intangibles	1,384.3	1,284.6
	$9,022.7	$8,027.1
Liabilities and Shareholders' Equity		
Current Liabilities		
Notes payable	$ 645.9	$ 232.7
Accounts payable	725.1	792.2
Income taxes payable	198.8	195.2
Other current liabilities	1,153.0	1006.1
	2,722.8	2,226.2
Long-term Debt	2,279.9	2,632.6
Nonrecourse Advance	299.3	–
Other Liabilities and Deferred Credits	407.5	336.6
Deferred Income Taxes	804.6	772.6
Shareholders' Equity		
Capital stock, par value 1 2/3¢ per share: authorized 600.0 shares, issued 287.7 shares	4.8	4.8
Capital in excess of par value	290.5	287.0
Retained earnings	2,776.7	2,356.6
Cumulative translation adjustment	(9.8)	(40.0)
Cost of treasury stock: 27.3 shares in 1987, 27.4 shares in 1986	(553.6)	(549.3)
	2,508.6	2,059.1
	$9,022.7	$8,027.1

See accompanying Notes to Consolidated Financial Statements.

Management's Analysis—Financial Condition

PepsiCo's overriding objective is to grow our shareholders' investment through integrated operating, investment and financial leverage strategies that seek to optimize cash returns and reduce the cost of capital. PepsiCo estimates its current cost of capital to be 11%.

Assets

Total assets increased $1 billion or 12% over 1986. This increase primarily reflected higher short-term investments, purchases of property, plant and equipment, acquisitions and investments in joint ventures.

The majority of PepsiCo's short-term investments consisted of tax-advantaged marketable securities portfolios held offshore. These investments have grown with the strong operating cash flows generated by our soft drink concentrate manufacturing facilities in Puerto Rico and Ireland, which operate under tax incentive grants. The investments are high grade and subject to prudent investment policy guidelines. Although PepsiCo has no plan to do so, liquidation and remittance of all these offshore investments at year-end 1987 would have resulted in incremental income tax expense of approximately $160 million. PepsiCo continually reassesses its alternatives to redeploy these funds on a more advantageous basis.

Long-term receivables, investments and other assets increased $184 million in 1987, primarily reflecting investments in new joint ventures in all three business segments. Joint venture activity is expected to play an increasingly important role, particularly in international markets as the synergies of our partners' local market knowledge and PepsiCo's operating and financial strengths create profitable growth opportunities.

PepsiCo's purchases of property, plant and equipment totaled $775 million and $882 million for 1987 and 1986, respectively, led by our restaurants segment. New unit development, particularly at Taco Bell, and refurbishments of existing units have driven these additions. The decline in spending from 1986 primarily reflected the completion of certain Frito-Lay manufacturing capacity additions and productivity projects initiated in prior years.

Goodwill and other intangibles increased $100 million over 1986, primarily reflecting the acquisitions of two franchised bottlers.

Liabilities

Total liabilities rose $546 million or 9% over 1986 primarily as a result of increased debt, including a nonrecourse advance. (See Note to Consolidated Financial Statements on page 45.)

The increase in total debt reflected higher levels of current debt and the 1987 nonrecourse advance, partially offset by lower long-term debt. The shift between current and long-term debt was due primarily to management's assessment as to the amount of short-term debt that will be refinanced on a long-term basis in the following year. At year-end 1986, PepsiCo had classified as long-term debt $922 million of commercial paper and notes due in 1987, which were substantially refinanced in 1987 through the nonrecourse advance and issuance of long-term debt. At year-end 1987, $150 million of commercial paper was classified as long-term debt, reflecting PepsiCo's intent and ability to refinance the commercial paper on a long-term basis in 1988. In March 1988 PepsiCo issued $100 million of 8% notes due in 1993.

Financial Leverage

In managing its capital structure, PepsiCo utilizes financial leverage to lower the overall cost of capital and increase returns to shareholders, without impairing PepsiCo's operating or financial flexibility.

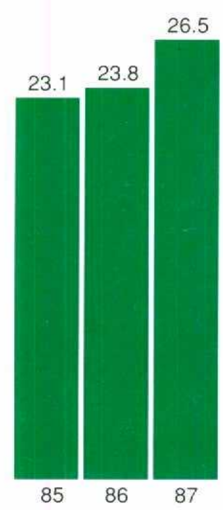
PepsiCo measures leverage on both a gross and net basis to take into account our sizeable short-term investment portfolios. On a gross basis, PepsiCo's ratio of total debt (including the nonrecourse advance) to capital employed (total debt, deferred income taxes, other liabilities and deferred credits and shareholders' equity) declined slightly to 46.4% at year-end 1987 from 47.5% at year-end 1986. Leverage on a net basis, which reflects the pro forma remittance of offshore short-term investment portfolios as a reduction of total debt and excludes the nonrecourse advance, was approximately 35% and slightly above 40% at year-end 1987 and 1986, respectively. Because the offshore portfolios do not impact the management of operating working capital, PepsiCo believes the net debt ratio is the better measure of financial leverage used in the business. PepsiCo has established a net debt target range of 35% to 40%, which could be exceeded for short periods, as in 1986, if warranted by appropriate investment opportunities.

PepsiCo's negative operating working capital position, which reflects the cash sales nature of its restaurant operations, is an interest-free source of capital. Operating working capital, which excludes short-term investments and notes payable, was a negative $448 million and $352 million at year-end 1987 and 1986, respectively.

Shareholders' Equity

Return on average shareholders' equity represents a combination of operating performance and the effect of financial leverage. Based on income from continuing operations, PepsiCo's return on average shareholders' equity was 26.5% in 1987, compared to 23.8% in 1986. This growth reflected the increase in income from continuing operations and the favorable impact of a 1985-1986 share repurchase program.

Return On Average Shareholders' Equity
(Percent)



Consolidated Statement of Changes in Financial Condition

(in millions)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 26, 1987, December 27, 1986 and December 28, 1985

	1987	1986	1985
Cash was Generated by (Used for):			
Continuing operations:			
Income	**$ 605.1**	$ 463.8	$ 426.6
Depreciation and amortization	**563.0**	396.1	286.2
Deferred income taxes	**59.0**	52.9	79.5
Other noncash charges and credits, net	**120.7**	84.4	80.8
Changes in operating working capital accounts (see details below)	**30.9**	237.0	(55.8)
Cash Generated by Continuing Operations	**1,378.7**	1,234.2	817.3
Investment activities:			
Acquisitions and investments	**(385.6)**	(1,720.8)	(160.0)
Purchases of property, plant and equipment	**(775.0)**	(882.2)	(770.3)
Proceeds from sales of property, plant and equipment	**102.1**	45.5	49.4
Proceeds from sale of North American Van Lines	**–**	375.7	–
Proceeds from sale of Wilson Sporting Goods	**–**	–	134.1
Proceeds from sales of other businesses	**161.6**	–	–
Other, net	**(123.9)**	71.4	(24.1)
Cash Used for Investment Activities	**(1,020.8)**	(2,110.4)	(770.9)
Financing activities*:			
Increase in long-term debt	**407.9**	1,371.1	689.9
Decrease in long-term debt	**(846.9)**	(114.8)	(219.7)
Increase (decrease) in notes payable	**413.2**	(159.9)	63.9
Nonrecourse advance received	**299.3**	–	–
Cash dividends declared	**(174.7)**	(162.6)	(161.2)
Purchase of treasury stock	**(18.6)**	(158.0)	(458.2)
Issuance of capital stock	**17.8**	83.3	51.5
Safe Harbor leases	**(23.7)**	(1.1)	114.0
Cash Generated by Financing Activities	**74.3**	858.0	80.2
Resulting in:			
Increase (decrease) in cash and short-term investments during the year	**$ 432.2**	$ (18.2)	$ 126.6
Details of Changes in Operating Working Capital Accounts Which Generated (Used) Cash*:			
Notes and accounts receivable	**$ (59.8)**	$ (47.2)	$ (65.9)
Inventories	**2.2**	23.9	(38.2)
Prepaid expenses, taxes and other current assets	**43.7**	26.5	(125.3)
Accounts payable	**(96.9)**	105.5	133.6
Income taxes payable	**18.5**	30.4	1.3
Other current liabilities	**123.2**	97.9	38.7
	$ 30.9	$ 237.0	$ (55.8)

*Does not include amounts related to acquisitions (at the dates of acquisition) and divestitures.

See accompanying Notes to Consolidated Financial Statements.

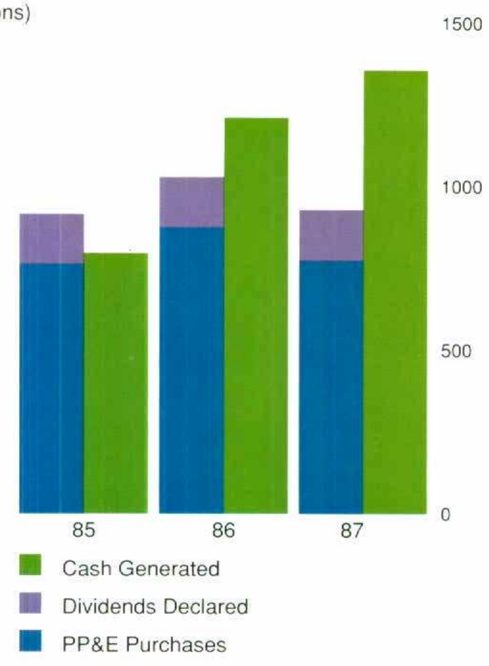
Management's Analysis—Changes in Financial Condition

Cash flow from continuing operations again reached a new record in 1987, continuing the momentum of PepsiCo's strategic actions to stimulate growth through investments in our existing business segments and improve cash flow returns. PepsiCo generated \$1.4 billion in cash from operations, which funded purchases of property, plant and equipment (PP&E) of \$775 million, acquisitions and investments of \$386 million, and dividends of \$175 million.

Cash Generated by Continuing Operations

The ability to generate funds internally continues to be one of PepsiCo's most significant financial strengths. In fact, in 1987 each business segment generated funds in excess of amounts required for its investment activities. Cash generated by continuing operations has averaged above \$1.1 billion per year over the past three years and, on a cumulative basis, has been sufficient to fund record purchases of PP&E and dividends in that time period.

Cash Generated By Continuing Operations vs. Purchases of PP&E and Dividends Declared
(\$ In Millions)



Cash generated by continuing operations in 1987 rose \$145 million or 12% over 1986. This increase reflected higher income after adjustments for noncash charges, partially offset by the effect of operating working capital changes. The increase in noncash charges was primarily due to higher depreciation and amortization associated with acquisitions. Operating working capital improvements continued to generate cash in 1987, but not at the 1986 rate primarily because of a decrease in accounts payable. In 1986 cash generated by continuing operations increased 51% from 1985, principally reflecting changes in operating working capital due to reduced inventories and prepaid taxes in 1986 and the initial prefunding of certain employee benefits in 1985.

Investment Activities

PepsiCo's investment activities in 1987, although lower in comparison with the record level achieved in 1986, reflected the goal of balanced sustainable growth in all segments through investments in PP&E, acquisitions and joint ventures. Acquisitions and investments activity in 1987 totaled \$386 million, which included \$197 million for the acquisitions of two franchised bottlers. Activity also included the acquisitions of two small restaurant businesses, which were absorbed into our existing systems, and two small foreign snack food companies, as well as joint venture investments primarily in domestic and international soft drinks.

The sale of businesses that no longer meet growth objectives is also a part of PepsiCo's investment strategy, as evidenced by the 1985 divestitures of North American Van Lines and Wilson Sporting Goods, and the sale of PepsiCo's retail bakery business, La Petite Boulangerie, in 1987. Major acquisition and divestiture activities are described on page 43 of Notes to Consolidated Financial Statements.

Financing Activities

Financing activities declined in 1987 as compared to 1986, when significant amounts of debt issuances were required to finance the 1986 acquisitions and the share repurchase program begun in 1985.

Share repurchases can be an effective means of achieving the target capital structure. The share repurchase program authorized by PepsiCo's Board of Directors in 1985 was completed in 1986; a total of 29 million shares was purchased at an aggregate cost of \$616 million. In October 1987 PepsiCo's Board of Directors authorized the repurchase from time to time of up to 15 million shares, of which 621,000 were purchased in late 1987 at an aggregate cost of \$19 million. Share repurchase decisions will be evaluated in light of other investment opportunities.

Cash dividends declared were a record \$175 million in 1987 and \$163 million in 1986. PepsiCo targets a payout of approximately one-third of the prior year's earnings, thus retaining sufficient earnings to enhance productive capability and provide adequate financial resources for growth opportunities.

PepsiCo maintained unused credit facilities approximating \$1.5 billion at year-end 1987, reduced upon re-evaluation of needs to \$1.2 billion beginning 1988. With its strong credit rating, PepsiCo maintains substantial flexibility and has access to capital markets throughout the world.

U.S. Tax Reform Act of 1986 (TRA)

The TRA will continue to have a modest favorable impact on PepsiCo's annual cash flow, as cash savings from reduced tax rates on domestic income are largely offset by the repeal of the investment tax credit.

The TRA had a significant impact on future cash flows related to PepsiCo's 1981 and 1982 investments in Safe Harbor leases (the Leases). Based on the reduced tax rates, future taxes payable related to the Leases (through the year 2005) were reduced by \$90 million beginning in 1987. (See Note to Consolidated Financial Statements on page 46.)

Consolidated Statement of Shareholders' Equity

(shares in thousands, dollars in millions, except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fifty-two weeks ended December 26, 1987, December 27, 1986 and December 28, 1985

	Capital Stock				Capital in Excess of Par Value	Retained Earnings	Cumulative Translation Adjustment	Total
	Issued		Treasury					
	Shares	Amount	Shares	Amount				
Shareholders' Equity, December 29, 1984	285,492	$ 4.8	(3,771)	$ (32.8)	$251.9	$1,678.9	$(49.4)	$1,853.4
1985 Net income						543.7		543.7
Cash dividends declared (per share–$0.59)						(161.2)		(161.2)
Shares reissued to Payroll-based Employee Stock Ownership Plan (PAYSOP)			227	4.0	0.5			4.5
Payment of compensation awards and exercise of stock options	468		75	1.3	5.5			6.8
Conversion of debentures	1,734		898	15.6	24.6			40.2
Translation adjustments (net of income taxes of $0.1)							8.5	8.5
Purchase of treasury stock			(22,005)	(458.2)				(458.2)
Shareholders' Equity, December 28, 1985	287,694	4.8	(24,576)	(470.1)	282.5	2,061.4	(40.9)	1,837.7
1986 Net income						457.8		457.8
Cash dividends declared (per share–$0.63)						(162.6)		(162.6)
Shares reissued to PAYSOP			173	3.5	1.1			4.6
Payment of compensation awards and exercise of stock options			577	11.6	(2.4)			9.2
Conversion of debentures			1,421	28.5	0.1			28.6
Translation adjustments (net of income taxes of $0.6)							0.9	0.9
Purchase of treasury stock			(6,725)	(158.0)				(158.0)
Shares issued in connection with an acquisition			1,755	35.2	5.7			40.9
Shareholders' Equity, December 27, 1986	287,694	4.8	(27,375)	(549.3)	287.0	2,356.6	(40.0)	2,059.1
1987 Net income						594.8		594.8
Cash dividends declared (per share–$0.67)						(174.7)		(174.7)
Shares reissued to PAYSOP			139	2.7	2.6			5.3
Payment of compensation awards and exercise of stock options			332	6.7	2.7			9.4
Conversion of debentures			244	4.9	(1.8)			3.1
Translation adjustments ($0 tax effect)							30.2	30.2
Purchase of treasury stock			(621)	(18.6)				(18.6)
Shareholders' Equity, December 26, 1987	**287,694**	**$ 4.8**	**(27,281)**	**$(553.6)**	**$290.5**	**$2,776.7**	**$ (9.8)**	**$2,508.6**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(in millions except share amounts)

Summary of Significant Accounting Policies

Principles of Consolidation. The financial statements reflect the consolidated accounts of PepsiCo, Inc. and its wholly-owned subsidiaries and certain joint ventures controlled by Kentucky Fried Chicken. All significant intercompany accounts and transactions were eliminated. Certain reclassifications were made to 1986 and 1985 amounts to conform with the 1987 presentation.

Goodwill and Other Intangibles. Goodwill represents the excess of purchase price over the fair value of identifiable net assets of companies acquired. Goodwill and other intangibles are amortized on a straight-line basis over appropriate periods not exceeding 40 years. Amortization included in the Consolidated Statement of Income under the caption "Marketing, administrative and other expenses" in 1987, 1986 and 1985 was $48 million, $24 million and $6 million, respectively.

Marketing Costs. Costs of materials in inventory and prepayments are deferred. With the exception of certain promotional discounts expensed as incurred, all other costs of advertising and other marketing and promotional programs are charged to expense ratably over the year in which incurred, generally in relation to sales.

Net Income Per Share. Net income per share is computed by dividing net income (adjusted for interest expense related to certain convertible debentures) by the weighted average number of shares and share equivalents outstanding during each year. The conversion of all convertible debentures would not result in a material dilution.

Acquisitions

In May 1986 PepsiCo acquired the soft drink business of MEI Corporation (MEI), a franchised bottler, for $591 million in cash.

In July 1986 PepsiCo acquired the international franchise soft drink business and certain Canadian bottling operations of The Seven-Up Company (Seven-Up International) for $246 million in cash. Consistent with management's intention in 1986, one of the bottling operations was sold to a franchised bottler for approximately $45 million in cash in July 1987. No gain or loss resulted from the sale.

In October 1986 PepsiCo acquired the Kentucky Fried Chicken operations (KFC) for $841 million in cash.

The acquisitions of MEI, Seven-Up International and KFC are accounted for by the purchase method; accordingly, their results are included in the Consolidated Financial Statements from their respective dates of acquisition. Under the purchase method, the excess of the purchase price over the fair value of identifiable net assets acquired is recorded as goodwill. The final combined purchase price allocation, which reflects refinements to the preliminary purchase price allocation used to record these acquisitions in 1986, follows:

Current assets	$ 267.8
Property, plant and equipment	824.3
Goodwill and other intangibles	984.4
Other noncurrent assets	142.6
Current liabilities	(286.7)
Long-term debt	(144.3)
Other noncurrent liabilities	(72.1)
	$1,716.0

The above purchase price allocation includes an additional payment in 1987 of $38 million related to a tax election for MEI that is expected to produce significantly larger future tax benefits.

The unaudited pro forma combined results of PepsiCo, MEI, Seven-Up International and KFC, had the acquisitions occurred at the beginning of each of the periods presented, are provided in the following table. The pro forma information does not necessarily represent what the actual consolidated results would have been for 1986 and 1985 and is not intended to be indicative of future results.

	1986	1985
Net sales	$10,579.1	$9,394.3
Income from continuing operations	$ 461.1	$ 396.8
Per share	$ 1.76	$ 1.42
Net income	$ 455.1	$ 513.9
Per share	$ 1.74	$ 1.83

In 1987, 1986 and 1985, PepsiCo made several other acquisitions that collectively were not significant to the Consolidated Financial Statements.

Discontinued Operations

In 1987 PepsiCo sold La Petite Boulangerie, Inc. (LPB), its retail bakery operation, for $15 million in cash. The sale produced a loss of $16 million before-tax and $9 million after-tax ($0.03 per share).

In 1985 PepsiCo sold its Wilson Sporting Goods operation (Wilson) for $134 million, consisting of cash and Wilson 10% cumulative preferred stock (the Stock). The sale resulted in a loss of $41 million before-tax and $18 million after-tax ($0.06 per share). In 1987 PepsiCo and the buyer of Wilson reached agreement on the closing balance sheet of Wilson with no material impact on PepsiCo's consolidated results or financial condition. In a related transaction, the Stock was sold for cash to the buyer of Wilson for an amount slightly in excess of its carrying value.

The sale of North American Van Lines, Inc. (NAVL) also was completed in 1985 for a $369 million interest-bearing deferred payment received on January 2, 1986. The sale resulted in a gain of $194 million before-tax and $139 million after-tax ($0.50 per share).

The sale of Lee Way Motor Freight, Inc. (Lee Way) was completed in 1984, resulting in a loss of $16 million before-tax and $15 million after-tax ($0.05 per share). In 1985 an additional loss of $10 million before-tax and $7 million after-tax ($0.03 per share) was recorded for payments made and costs incurred by PepsiCo under certain guarantees that existed at, or were entered into in connection with, the sale of Lee Way. The purchaser of Lee Way merged into Lee Way in 1985, shortly before filing for bankruptcy. The merged company is now in liquidation. PepsiCo has filed a claim to recover amounts paid or payable under the guarantees and claims have been asserted against PepsiCo by the purchaser and others. Although the outcome of all such claims and related litigation is uncertain, management believes they will not have a material effect on PepsiCo's business or financial condition.

The 1987 loss on the sale of LPB and the 1985 net gain related to Wilson, NAVL and Lee Way were reflected in the Consolidated Statement of Income under the caption "(Loss) gain on disposals." The results of the operations of LPB, Wilson and NAVL, through their respective dates of sale, were included in the Consolidated Statement of Income under the caption "(Loss) income from discontinued operations." Net sales related to discontinued operations were $15 million, $43 million and $454 million in 1987, 1986 and 1985, respectively.

Notes Payable and Long-term Debt

	1987	1986
Notes Payable		
Current maturities on long-term debt and capital lease obligations	$ 165.2	$ 31.8
Commercial paper	273.3	–
Other notes payable, primarily to foreign banks	207.4	200.9
	$ 645.9	$ 232.7
Long-term Debt		
Commercial paper (7.4% and 5.9% weighted average interest rate at year-end 1987 and 1986, respectively) **(A)**	$ 150.0	$ 837.2
Notes due 1989 through 1998 (7.6% and 7.5% weighted average interest rate at year-end 1987 and 1986, respectively) **(B)**	827.5	715.8
Swiss franc perpetual Foreign Interest Payment bonds **(C)**	207.6	206.8
Zero coupon notes (various), $1.1 billion due 1989-2012 (14.1% semi-annual weighted average yield to maturity)	238.8	213.1
Australian dollar notes due 1989 and 1990 (13.6% and 13.7% weighted average interest rate at year-end 1987 and 1986, respectively) **(D)**	124.5	82.8
European Currency Units 7⅝% notes due 1990 **(D)**	126.5	–
New Zealand dollar 18½% notes due 1989 **(D)**	39.1	–
Swiss franc 5¼% bearer bonds due 1995 **(D)**	99.1	79.6
Italian lire 10½% notes due 1991 **(D)**	83.7	73.5
Canadian dollar 8¾% notes due 1991 **(B)**	57.0	53.9
Capital lease obligations	129.3	139.7
Other, due 1989-2014 (10.3% and 13.3% weighted average interest rate at year-end 1987 and 1986, respectively)	196.8	230.2
Total long-term debt **(E)(F)**	$2,279.9	$2,632.6

For additional information on capital lease obligations, see Note on page 45.

(A) At year-end 1987, PepsiCo had revolving credit agreements aggregating $1.5 billion, reduced to $1.2 billion beginning 1988, covering potential borrowings through 1992. These unused credit facilities provide PepsiCo with the ability to refinance short-term borrowings and currently support the classification of $150 million of commercial paper due in 1988 as long-term debt, as it is PepsiCo's intent to refinance these amounts on a long-term basis in 1988.

(B) PepsiCo has utilized interest rate swap agreements to effectively convert $477 million of fixed interest rate long-term debt to variable rate long-term debt with a weighted average interest rate of 7.5% at year-end 1987.

(C) The coupon rate of the Swiss franc perpetual 400 million Foreign Interest Payment bonds is 7½% through 1996. The principal of the bonds is payable in Swiss francs and the interest payments will be made in U.S. dollars at a fixed contractual exchange rate. At the end of each 10-year period after the issuance of the bonds: (i) PepsiCo will have the right to redeem the bonds at their face amount; (ii) the bondholders will have the right to cause PepsiCo to redeem the bonds at the lesser of their face amount or the Swiss franc equivalent of the U.S. dollar proceeds received at issuance (the proceeds amount); or (iii) if the bonds are not redeemed, the coupon rate will be adjusted based on the prevailing yield of 10-year U.S. Treasury Securities. As it is PepsiCo's intent not to redeem the bonds, the proceeds amount is the basis of the carrying value of the bonds in the Statement of Financial Condition.

(D) PepsiCo has entered into foreign currency exchange agreements to hedge its foreign currency exposure on these issues of non-U.S. dollar denominated debt. At year-end 1987, the agreements effectively establish U.S. dollar liabilities of $160 million with a weighted average fixed interest rate of 8.6%, and $221 million with a weighted average variable interest rate of 7.2%.

(E) In 1984 PepsiCo issued $104 million Deutsche mark denominated bearer bonds yielding 7¼%, due 1994. PepsiCo defeased the bonds in 1984 by depositing higher yielding notes of the West German Government in an irrevocable trust established for the sole purpose of servicing the interest and principal on the bonds. The bonds and West German Government notes were offset in the Consolidated Statement of Financial Condition.

(F) Long-term debt is carried net of any related discount or premium and unamortized debt issuance costs. Foreign currency denominated debt has been valued in the Consolidated Statement of Financial Condition at year-end exchange rates. The annual maturities of long-term debt through 1992, excluding capital lease obligations and the commercial paper to be refinanced in 1988, are: 1988-$151 million; 1989-$316 million; 1990-$269 million; 1991-$366 million; and 1992-$72 million. The debt agreements include various restrictions, none of which is presently significant to PepsiCo.

Nonrecourse Advance

In 1987 PepsiCo entered into an agreement under which it received a nonrecourse advance of $299 million, net of related expenses (the Advance). The Advance and related interest are payable solely from future royalty payments to be received from certain domestic franchisees of one of PepsiCo's restaurant systems, for a period not to exceed 10 years. The Advance carries a variable interest rate (7.6% as of December 26, 1987) based upon a commercial paper rate. Under the terms of the agreement, principal repayments during the first three years can be readvanced; as it is PepsiCo's intent to elect this provision, the entire Advance is considered a noncurrent obligation. Principal repayments, net of amounts readvanced, are estimated to be $178 million over the next five years.

Leases

PepsiCo has noncancelable commitments under both capital and operating leases, primarily for restaurant units. Certain of these units have been subleased to restaurant franchisees. Lease commitments on capital and operating leases expire at various dates through 2031.

Future minimum lease commitments and sublease receivables under noncancelable leases:

	Commitments		Sublease Receivables	
	Capital	Operating	Direct Financing	Operating
1988	$ 29.4	$110.7	$ 6.5	$ 9.1
1989	27.2	98.0	6.2	8.8
1990	25.8	90.5	6.1	8.4
1991	23.9	80.1	6.0	8.0
1992	22.0	74.3	5.9	7.7
Later years	114.8	480.6	43.5	58.0
	$243.1	$934.2	$ 74.2	$100.0

At year-end 1987, the present value of minimum lease commitments for capital leases was $143 million after deducting $1 million for estimated executory costs (taxes, maintenance and insurance) and $99 million representing imputed interest. The present value of minimum sublease receivables was $37 million after deducting $37 million of unearned interest income.

Rental expense and income under operating leases and subleases, respectively:

	Rental	
	Expense	Income
1987	**$204.8**	**$16.6**
1986	147.2	17.1
1985	113.8	15.6

Refranchising Program

At the end of 1987 and 1986, only one of the foreign company-owned bottling operations in the 1984 Refranchising Program (the Program) had not been sold, for which management is continuing to pursue various alternatives. The Program was established to sell several foreign company-owned bottling operations to franchised bottlers.

The net liability arising from the Program of $51 million and $54 million at year-end 1987 and 1986, respectively, was included in the Consolidated Statement of Financial Condition under the caption "Other current liabilities." The net liability included accruals for disposition losses related to the remaining bottling operation and other obligations arising from the Program, less the net assets of the remaining bottling operation.

Inventories

Inventories are valued at the lower of cost (computed on the average, first-in, first-out or last-in, first-out method) or net realizable value. Inventories computed on the last-in, first-out (LIFO) method comprised 57% and 59% of inventories at year-end 1987 and 1986, respectively.

	1987	1986
Raw materials, supplies and in-process	**$241.7**	$250.3
Finished goods	**201.4**	189.3
Total (approximates current cost)	**443.1**	439.6
Excess of current cost over LIFO cost	**(10.1)**	(9.7)
	$433.0	$429.9

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is calculated principally on a straight-line basis over the estimated useful lives of the assets. Interest capitalized as an additional cost of property, plant and equipment was $5 million in 1987, $11 million in 1986 and $13 million in 1985.

	1987	1986
Land	**$ 500.9**	$ 413.3
Buildings and building improvements	**1,949.5**	1,694.8
Machinery and equipment	**3,352.2**	3,056.6
Capital leases, primarily buildings	**198.0**	191.8
	6,000.6	5,356.5
Accumulated depreciation and amortization	**(1,883.2)**	(1,538.9)
	$ 4,117.4	$ 3,817.6

Income Taxes

Provision for income taxes on income from continuing operations:

	1987	1986	1985
Current – Federal	$231.2	$142.0	$ 89.7
Foreign	28.9	10.8	6.5
State	23.0	19.4	7.6
	283.1	172.2	103.8
Deferred – Federal	32.9	58.6	146.1
Foreign	(2.2)	(15.2)	8.3
State	41.5	13.4	–
	72.2	56.8	154.4
	$355.3	$229.0	$258.2

Deferred taxes were not provided on unremitted earnings of subsidiaries operating outside the United States that are intended to be indefinitely reinvested. These unremitted earnings aggregated approximately $549 million at year-end 1987, exclusive of amounts that if remitted in the future would result in little or no tax under current tax laws. In 1986 PepsiCo reversed previously provided deferred foreign taxes of $18 million, reflecting management's decision to indefinitely reinvest certain unremitted prior years' foreign earnings.

U.S. and foreign income from continuing operations before income taxes:

	1987	1986	1985
U.S.	$610.5	$400.4	$461.4
Foreign	349.9	292.4	223.4
	$960.4	$692.8	$684.8

Consistent with the allocation for tax purposes, approximately 50% of the income arising from the sale of soft drink concentrate that is manufactured in Puerto Rico is included in Foreign in the above table. PepsiCo has soft drink concentrate manufacturing facilities in Puerto Rico and Ireland that operate under tax incentive grants that expire in 1991 and 1989, respectively.

Reconciliation of the U.S. federal statutory tax rate to PepsiCo's effective tax rate on income from continuing operations:

	1987	1986	1985
U.S. federal statutory tax rate	40.0%	46.0%	46.0%
State income tax net of federal tax benefit	4.2	2.6	0.6
Earnings in jurisdictions taxed at lower rates (principally Puerto Rico and Ireland)	(7.2)	(10.2)	(5.5)
Investment tax credits	(1.6)	(2.6)	(2.8)
Deferred taxes no longer required on unremitted earnings	–	(2.5)	–
Other, net	1.6	(0.2)	(0.6)
Effective tax rate	37.0%	33.1%	37.7%

Deferred income tax expense on continuing operations arose from the following:

	1987	1986	1985
Depreciation	$ 66.5	$ 64.4	$ 41.4
Refranchising program	2.5	25.3	55.0
Financing transactions	7.0	10.9	6.1
Discontinued product costs	10.2	(23.6)	(5.3)
Investment tax credits	(15.1)	(13.4)	13.1
Prefunded employee benefits	8.3	(2.9)	31.3
Other, net	(7.2)	(3.9)	12.8
	$ 72.2	$ 56.8	$154.4

Deferred income taxes reflected in the Consolidated Statement of Financial Condition were comprised of the following:

	1987	1986
Deferred Income Taxes:		
Taxes payable		
– Temporary differences	$507.3	$436.5
– Safe Harbor leases	247.7	271.4
Investment tax credits	49.6	64.7
	$804.6	$772.6
Deferred income taxes included in "Prepaid expenses, taxes and other current assets"	$ 53.7	$122.9

The U.S. Tax Reform Act of 1986 (TRA) reduced the 1987 provision for income taxes by an estimated $30 million, primarily reflecting the lower federal statutory tax rate, but had an insignificant impact on the 1986 provision for income taxes. The repeal of the investment tax credit (ITC) by the TRA had a modest impact on PepsiCo's 1987 and 1986 effective tax rate because PepsiCo amortizes the benefits of ITC for financial reporting purposes over the estimated useful lives of the related assets.

In 1986 deferred federal income taxes payable related to Safe Harbor leases (the Leases) were reduced by $90 million as a result of the lower federal statutory tax rates for 1987 and subsequent years provided by the TRA. In 1981 and 1982 PepsiCo invested in the Leases, which effectively are financing transactions that decrease income taxes payable over the initial years of the Leases and increase them over the later years. A $22 million gain, representing the reduction in the deferred tax liability net of the remaining investment in the Leases, was included in the 1986 Consolidated Statement of Income under the caption "Marketing, administrative and other expenses." Taxes payable related to the Leases are estimated to be $73 million over the next five years.

The Financial Accounting Standards Board issued Statement No. 96 on Accounting for Income Taxes (SFAS 96) in December 1987. Under SFAS 96, PepsiCo is required to adopt the provisions on either a prospective or retroactive basis no later than its fiscal year ending December 30, 1989. The adoption of SFAS 96 will impact PepsiCo's deferred income taxes payable related to temporary differences as well as the amount included in "Prepaid expenses, taxes and other current assets." PepsiCo has not yet determined when it will adopt SFAS 96, nor whether it will be prospectively or retroactively applied. Assuming the recently reduced tax rates continue, the adoption of SFAS 96 prospectively is expected to have a favorable impact on net income resulting primarily from a reduction in net deferred income taxes to amounts estimated to be paid in future years.

Retirement Plans

Effective December 28, 1986, PepsiCo adopted Financial Accounting Standard No. 87 (SFAS 87), on Employers' Accounting for Pensions, for all company-sponsored domestic plans. The effect of adopting SFAS 87 was a reduction in 1987 pension expense of $50 million and a change in the amortization period of prior service costs from 30 years to a range between 11 and 19 years, the average remaining service years of employees expected to receive benefits. As required by SFAS 87, pension expense and related disclosures for all domestic plans in 1986 and 1985 were determined under the provisions of previous accounting principles.

PepsiCo has several noncontributory defined benefit pension plans covering substantially all domestic employees. Generally, benefits for salaried employees are based on years of service and the employees' highest consecutive five-year average annual earnings. The hourly plans provide benefits based on specified amounts and credited service. PepsiCo funds these plans in amounts not less than minimum statutory funding requirements nor more than the maximum amount which can be deducted for federal income tax purposes. The plan assets consist principally of equity securities, government and corporate debt securities and other fixed income obligations. Capital stock of PepsiCo accounted for approximately 12% of the total market value of plan assets at year-end 1987.

Pension expense for the company-sponsored domestic plans (the Plans) was a credit of $11.5 million in 1987 and a charge of $32.2 million and $33.1 million for 1986 and 1985, respectively. The decrease in 1987 resulted principally from the adoption of SFAS 87.

The net pension credit for the Plans in 1987 included the following components:

Service cost of benefits earned during the year		$ 29.5
Interest cost on the projected benefit obligations		38.1
Return on the Plans' assets:		
Actual	$(50.9)	
Deferred gain	(9.2)	(60.1)
Amortization of net transition gain		(19.0)
1987 pension credit		$(11.5)

In determining the 1987 pension credit, the assumed discount rate and the expected long-term rate of return applied to the fair market value of the Plans' assets were 8.6% and 10.0%, respectively.

A reconciliation of the funded status of the Plans at year-end 1987 to the accrued pension liability included in the Consolidated Statement of Financial Condition is as follows:

	Plans with Assets Exceeding Accumulated Benefits	Plans with Accumulated Benefits Exceeding Assets
Actuarial present value of benefit obligations:		
Vested benefits	$(266.2)	$ (4.4)
Nonvested benefits	(65.5)	(0.8)
Accumulated benefit obligation	(331.7)	(5.2)
Effect of projected compensation increases	(68.4)	(2.2)
Projected benefit obligation	(400.1)	(7.4)
Plan assets at fair value	646.5	0.4
Plan assets in excess of (less than) projected benefit obligation	246.4	(7.0)
Unamortized prior service cost	0.4	–
Unamortized net gain	(76.7)	(1.5)
Unamortized net transition (gain) loss	(205.9)	0.8
Accrued pension liability	$ (35.8)	$ (7.7)
Included in:		
Other current liabilities	$ (4.4)	$ (0.2)
Other liabilities and deferred credits	$ (31.4)	$ (7.5)

The assumed discount rate and future compensation growth rates used in determining the actuarial present value of the projected benefit obligation were 10.0% and a range of 5.0% to 7.0%, respectively.

At January 1, 1986, the actuarial present value of accumulated plan benefits was calculated using a weighted average assumed rate of return of 7.0% and totaled $419 million (of which $328 million was vested). Net assets available for the Plans' benefits at January 1, 1986 were $574 million.

Domestic employees not covered by the Plans are generally covered by multiemployer plans as part of collective-bargaining agreements. Pension expense for these multiemployer plans was not significant in the aggregate.

Pension coverage for employees of PepsiCo's non-U.S. subsidiaries is provided through separate plans, many of which are governed by local statutory requirements. Pension expense for these foreign plans, which was determined under the provisions of previous accounting principles, was not significant in the aggregate.

PepsiCo provides certain health care and life insurance benefits to retired nonunion employees. The annual costs of these benefits, which are not significant, are expensed as health care claims are incurred and life insurance premiums are paid.

Management Incentive Plan

The shareholder-approved 1979 Incentive Plan, which expired on December 31, 1987, provided long-term incentives to certain key management employees through grants in alternate fiscal years of performance shares, stock options, stock appreciation rights (SARs) and incentive stock units. The shareholder-approved 1987 Incentive Plan, effective 1988, continues the principal features of the 1979 Incentive Plan and authorizes up to a maximum of 18 million shares of PepsiCo Capital Stock to be purchased or paid pursuant to grants by the Compensation Committee of the Board of Directors (the Committee). Payment of awards is made in cash and/or PepsiCo Capital Stock as determined by the Committee. The Committee is composed of outside directors.

A performance share is equivalent to one share of PepsiCo Capital Stock and is granted to senior management employees. Performance shares vest and are payable four years after the date of grant, contingent upon attainment of prescribed performance criteria. The holder receives the fair market value of PepsiCo Capital Stock at the date of the grant.

An equal number of stock options are granted with performance share awards. Each stock option represents the right to purchase one share of PepsiCo Capital Stock for a specified period falling between 4 and 15 years from the date of grant at a price not less than the fair market value at the date of grant.

Beginning in 1988, senior management employees will be granted stock options in lieu of performance shares, which may subsequently be converted to performance shares at the employee's election within 60 days. In January 1988, 3,268,204 stock options were granted. Of this amount, 2,451,153 are convertible to 817,051 performance shares.

SARs, available to certain employees holding stock options, are granted in the year the related options become exercisable. They allow the employee to surrender an option for an amount equal to the appreciation between the option exercise price and the fair market value of PepsiCo Capital Stock on the date the SAR is exercised. SARs expire no later than the expiration date of the related options. In January 1988, 328,755 SARs were granted.

An incentive stock unit (Unit) is equivalent to one share of PepsiCo Capital Stock and is awarded to middle management employees. The Units vest over a six-year period from the date of grant, and the value is based on the fair market value of PepsiCo Capital Stock at specified vesting dates.

The fair market value of PepsiCo Capital Stock related to the awards is determined as the lesser of the market value on the day prior to grant or vesting date or the average market value over the 30 days preceding the grant or vesting date.

The estimated costs of performance shares, SARs and Units, which are expensed over the applicable vesting periods of the awards, were $20 million, $17 million and $19 million in 1987, 1986 and 1985, respectively.

Award activity under PepsiCo's management incentive plan for 1987 was as follows:

	Performance Shares	Stock Options	Incentive Stock Units
Outstanding at December 27, 1986	1,944,068	2,471,882	658,984
Granted	–	1,210,000	204,725
Exercised	–	(167,198)	(225,300)
Surrendered for SARs		(167,441)	
Cancelled	(174,835)	(205,000)	(76,125)
Outstanding at December 26, 1987	1,769,233	3,142,243	562,284
Exercisable at December 26, 1987		65,958	

Option prices per share	
Exercised during the year	$11.56 to $26.25
Outstanding at year-end	$12.33 to $32.06

Contingencies

PepsiCo is involved in various claims and legal proceedings, the resolution of which management believes will not have a material effect on PepsiCo's business or financial condition. PepsiCo intends to prosecute or defend vigorously, as the case may be, all such matters.

At year-end 1987 PepsiCo was contingently liable under direct and indirect guarantees aggregating $66 million.

Management's Responsibility for Financial Reporting

To Our Shareholders:

Management is responsible for the integrity and objectivity of the consolidated financial statements and related notes. To meet these responsibilities, we maintain a system of internal control, supported by formal policies and procedures, which include an active code of conduct program intended to ensure key employees adhere to the highest standards of personal and professional integrity. PepsiCo's internal audit function monitors and reports on the adequacy of and compliance with our internal controls, policies and procedures. Although no cost effective internal control system will preclude all errors and irregularities, we believe the established system of internal control provides reasonable assurance that assets are safeguarded, transactions are recorded in accordance with our policies and the financial information is reliable.

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles applied on a consistent basis, except for the required 1987 change in the method of accounting for pensions as described in the Note to Consolidated Financial Statements appearing on page 47, and include amounts based upon our estimates and judgments, as required. The consolidated financial statements have been audited by Arthur Young & Company who have expressed their opinion, presented below, with respect to the fairness of the statements. Their examination included a review of the system of internal control and tests of transactions to the extent they considered necessary to render their opinion.

The Audit Committee of the Board of Directors is composed solely of outside directors. The Audit Committee meets periodically with Arthur Young & Company, our internal auditors and PepsiCo management to review accounting, auditing, internal control and financial reporting matters. Both Arthur Young & Company and our internal auditors have free access to the Audit Committee.

Wayne Calloway

D. Wayne Calloway
Chairman of the Board
and Chief Executive Officer

Robert G Dettmer

Robert G. Dettmer
Executive Vice President
and Chief Financial Officer

Report of Certified Public Accountants

Board of Directors and Shareholders
PepsiCo, Inc.

We have examined the accompanying consolidated statement of financial condition of PepsiCo, Inc. and subsidiaries at December 26, 1987 and December 27, 1986, and the related consolidated statements of income, changes in financial condition and shareholders' equity for each of the three years in the period ended December 26, 1987, appearing on pages 34, 35, 36, 38, 40, 42 through 48. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of PepsiCo, Inc. and subsidiaries at December 26, 1987 and December 27, 1986 and the consolidated results of operations and changes in financial position for each of the three years in the period ended December 26, 1987, in conformity with generally accepted accounting principles applied on a consistent basis during the period except for the change, with which we concur, in the method of accounting for pensions as described in the Note to Consolidated Financial Statements appearing on page 47.

Arthur Young & Company

277 Park Avenue
New York, New York
February 2, 1988

Selected Financial Data

(in millions except per share, shareholder and employee amounts, unaudited)
PepsiCo, Inc. and Subsidiaries

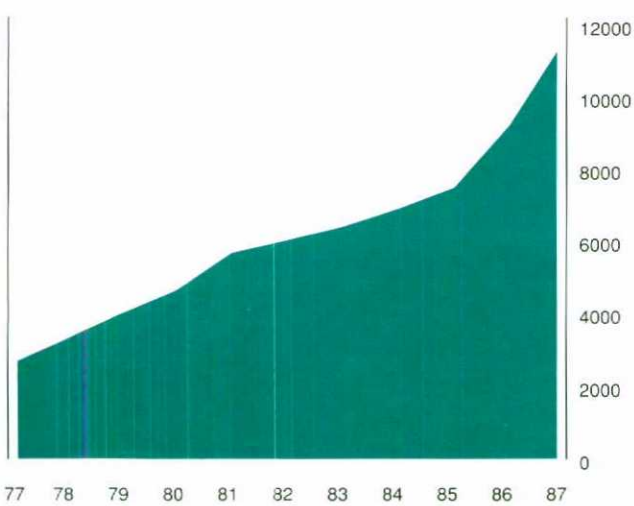
	Growth Rates Compounded 10-Year 1977-87	Growth Rates Compounded 5-Year 1982-87	Growth Rates Annual 1-Year 1986-87	1987[a]	1986[b]
Summary of Operations					
Net sales	14.6%	12.9%	26.1%	**$11,485.2**	$9,109.9
Cost of sales and operating expenses				**10,341.9**	8,276.9
Interest expense				**296.8**	263.1
Interest income				**(113.9)**	(122.9)
				10,524.8	8,417.1
Income from continuing operations before income taxes				**960.4**	692.8
Provision for income taxes				**355.3**	229.0
Income from continuing operations	13.2%	24.3%	30.5%	**$ 605.1**	$ 463.8
Net income	11.7%	21.5%	29.9%	**$ 594.8**	$ 457.8
Income per share from continuing operations	13.6%	25.8%	29.9%	**$ 2.30**	$ 1.77
Net income per share	12.1%	23.1%	29.1%	**$ 2.26**	$ 1.75
Average shares and equivalents outstanding				**263.1**	262.2
Cash dividends declared	10.1%	3.5%	7.4%	**$ 174.7**	$ 162.6
Per share	9.3%	4.9%	6.7%	**$ 0.670**	$ 0.628
Year-End Position					
Total assets				**$ 9,022.7**	$8,027.1
Long-term debt				**$ 2,579.2**[f]	$2,632.6
Shareholders' equity				**$ 2,508.6**	$2,059.1
Per share				**$ 9.64**	$ 7.91
Market price per share	13.8%	24.5%	29.0%	**$ 33⅞**	$ 26¼
Shares outstanding				**260.4**	260.3
Employees				**225,000**	214,000
Shareholders of record				**92,000**	87,000
Statistics					
Return on average shareholders' equity (g)				**26.5%**	23.8%
Return on net sales (g)				**5.3%**	5.1%
Total debt to total capital employed (h)				**46.4%**	47.5%

The above amounts have been restated to reflect the divestiture of La Petite Boulangerie (see Note to Consolidated Financial Statements on page 43) and certain other reclassifications to conform to the 1987 presentation.

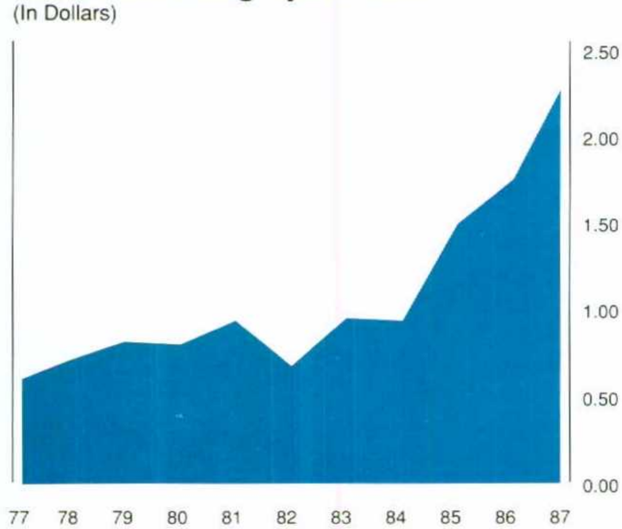
(a) PepsiCo adopted the Financial Accounting Standard (SFAS) No. 87 on Employers' Accounting for Pensions. Prior years are not restated for SFAS 87. (See Note to Consolidated Financial Statements on page 47.)
(b) Includes the results of MEI Corporation, Seven-Up International and Kentucky Fried Chicken from their respective dates of acquisition. (See Note to Consolidated Financial Statements on page 43.)
(c) PepsiCo adopted the Financial Accounting Standard (SFAS) No. 52 on Foreign Currency Translation. Prior years are not restated for SFAS 52.
(d) In 1984 a $156.0 charge was recorded related to the planned sale of several company-owned foreign bottling operations ($62.0 after-tax or $0.22 per share). In 1985 a $25.9 credit was recorded as an adjustment to the charge ($14.9 after-tax or $0.05 per share).
(e) Includes a $79.4 charge related to a reduction in net assets of certain foreign bottling operations ($79.4 after-tax or $0.28 per share).
(f) Long-term debt includes a nonrecourse advance. (See Note to Consolidated Financial Statements on page 45.)
(g) The return on average shareholders' equity and return on net sales are calculated using income from continuing operations.
(h) Total debt includes notes payable and long-term debt; total capital employed includes total debt, shareholders' equity, deferred income taxes and other liabilities and deferred credits.

1985	1984	1983	1982[c]	1981	1980	1979	1978	1977
$7,621.5	$7,091.7	$6,598.0	$6,261.7	$5,873.3	$4,955.9	$4,198.9	$3,523.7	$2,939.7
6,837.9[d]	6,511.8[d]	6,024.3	5,712.9[e]	5,278.8	4,435.7	3,734.7	3,104.6	2,586.3
195.2	204.9	175.0	163.5	147.7	112.7	71.2	50.1	44.9
(96.4)	(86.1)	(53.6)	(49.1)	(35.8)	(27.1)	(21.9)	(19.3)	(21.7)
6,936.7	6,630.6	6,145.7	5,827.3	5,390.7	4,521.3	3,784.0	3,135.4	2,609.5
684.8	461.1	452.3	434.4	482.6	434.6	414.9	388.3	330.2
258.2	181.1	170.4	230.8	213.7	200.3	176.3	179.8	154.7
$ 426.6	$ 280.0	$ 281.9	$ 203.6	$ 268.9	$ 234.3	$ 238.6	$ 208.5	$ 175.5
$ 543.7	$ 212.5	$ 284.1	$ 224.3	$ 297.5	$ 260.7	$ 250.4	$ 223.2	$ 196.7
$ 1.53[d]	$ 0.99[d]	$ 1.00	$ 0.73[e]	$ 0.97	$ 0.86	$ 0.86	$ 0.75	$ 0.64
$ 1.94	$ 0.75	$ 1.00	$ 0.80	$ 1.07	$ 0.95	$ 0.90	$ 0.80	$ 0.72
280.7	287.5	286.4	284.7	279.2	273.5	278.4	278.6	276.1
$ 161.2	$ 156.2	$ 151.4	$ 147.1	$ 129.9	$ 114.9	$ 102.4	$ 88.4	$ 67.0
$ 0.585	$ 0.555	$ 0.540	$ 0.527	$ 0.473	$ 0.420	$ 0.368	$ 0.325	$ 0.275
$5,889.3	$4,876.9	$4,446.3	$4,047.0	$3,960.2	$3,309.7	$2,800.0	$2,293.4	$2,031.7
$1,162.0	$ 668.1	$ 797.8	$ 843.2	$ 804.6	$ 769.5	$ 601.2	$ 459.9	$ 463.1
$1,837.7	$1,853.4	$1,794.2	$1,650.5	$1,556.3	$1,509.7	$1,387.2	$1,336.7	$1,159.5
$ 6.98	$ 6.58	$ 6.39	$ 5.89	$ 5.66	$ 5.51	$ 5.08	$ 4.79	$ 4.21
$ 23¾	$ 14	$ 12¾	$ 11⅓	$ 12⅛	$ 8⅔	$ 8⅓	$ 8½	$ 9⅓
263.1	281.7	280.7	280.1	274.8	273.8	272.9	279.2	275.4
150,000	150,000	154,000	133,000	120,000	111,000	105,000	95,000	83,000
72,000	62,000	60,000	48,000	49,000	51,000	53,000	55,000	52,000
23.1%	15.4%	16.4%	12.7%	17.5%	16.2%	17.5%	16.7%	16.2%
5.6%	3.9%	4.3%	3.3%	4.6%	4.7%	5.7%	5.9%	6.0%
34.4%	26.5%	31.6%	34.6%	40.7%	34.9%	31.3%	26.3%	29.2%

Net Sales
($ In Millions)



Income Per Share From Continuing Operations
(In Dollars)



Quarterly Financial Data

(in millions except per share amounts, unaudited)

	First Quarter (12 weeks)		Second Quarter (12 weeks)		Third Quarter (12 weeks)		Fourth Quarter (16 weeks)		Full Year (52 weeks)	
	1987	1986	**1987**	1986	**1987**	1986	**1987**	1986	**1987**	1986
Net sales	**$2,292.5**	1,711.3	**2,787.5**	2,039.2	**2,939.1**	2,324.9	**3,466.1**	3,034.5	**11,485.2**	9,109.9
Gross profit	**$1,379.5**	1,007.1	**1,716.9**	1,212.0	**1,787.3**	1,361.0	**2,142.3**	1,811.0	**7,026.0**	5,391.1
Income from continuing operations before income taxes	**$ 131.8**	116.5	**301.3**[b]	199.2	**303.8**	232.4	**223.5**	144.7[d,e]	**960.4**[f]	692.8
Provision for income taxes	**$ 50.1**	46.8	**112.3**	76.9	**113.9**	79.6	**79.0**	25.7	**355.3**	229.0[c]
Income from continuing operations	**$ 81.7**	69.7	**189.0**	122.3	**189.9**	152.8	**144.5**	119.0	**605.1**	463.8
(Loss) income from discontinued operations	**$ (12.8)**	(0.9)	**–**	(1.6)	**–**	(1.1)	**2.5**	(2.4)	**(10.3)**[a]	(6.0)
Net income	**$ 68.9**	68.8	**189.0**	120.7	**189.9**	151.7	**147.0**	116.6	**594.8**	457.8
Income (loss) per share:										
Continuing operations	**$ 0.31**	0.27	**0.72**[b]	0.47	**0.72**	0.58	**0.55**	0.45[d,e]	**2.30**[f]	1.77[c]
Discontinued operations	**$ (0.05)**	(0.01)	**–**	–	**–**	–	**0.01**	(0.01)	**(0.04)**[a]	(0.02)
Net income per share	**$ 0.26**	0.26	**0.72**	0.47	**0.72**	0.58	**0.56**	0.44	**2.26**	1.75

The 1986 amounts have been restated to reflect the divestiture of La Petite Boulangerie (see Note to Consolidated Financial Statements on page 43) and certain other reclassifications to conform to the 1987 presentation.

(a) Includes a $9.0 after-tax loss ($0.03 per share) resulting from the sale of La Petite Boulangerie.

(b) Includes $27.8 in gains resulting from sales of company-owned bottling operations in Puerto Rico, a Frito-Lay cookie production facility (see Note (d)) and several company-owned restaurants in Australia ($18.5 after-tax or $0.07 per share).

(c) Includes a $17.5 ($0.07 per share) reversal of previously provided deferred taxes as a result of management's third quarter decision to indefinitely reinvest certain unremitted prior years' foreign earnings.

(d) Includes a $52.0 charge related to the discontinuance of certain nonsalty snack products and a reduction of cookie production capacity ($26.5 after-tax or $0.10 per share). In 1987 a $12.5 credit was recorded as an adjustment to the charge, primarily reflecting the gain resulting from the sale of a cookie production facility in the second quarter.

(e) Includes $41.5 in gains from the collection of a foreign receivable written off in 1978 and the favorable impact of the U.S. Tax Reform Act of 1986 on PepsiCo's Safe Harbor leases ($37.1 after-tax gain or $0.14 per share).

(f) Includes the effect of adopting Financial Accounting Standard No. 87 on Employers' Accounting for Pensions, which reduced full-year pension expense by $49.5 ($28.3 after-tax or $0.11 per share). The pre-tax impact on each of the first three quarters was $10.5; the fourth quarter impact was $18.0.

Capital Stock Information

Stock Trading Symbol
PEP

Stock Exchange Listings
New York, Midwest, Basel,
Geneva, Zurich, Amsterdam, Tokyo

At year-end 1987, there were 92,000 shareholders of record.

Dividend Policy
Cash dividends are declared quarterly. On January 1, 1988 PepsiCo's quarterly dividend was $0.17 per share. We have paid quarterly cash dividends since PepsiCo was formed in 1965, and dividends have increased for 16 consecutive years.

The 1987 dividend payout ratio was 38% of 1986 earnings.

Dividends Paid Per Share

Quarter	1987	1986
1	**16¢**	14.8¢
2	**17¢**	16¢
3	**17¢**	16¢
4	**17¢**	16¢

Dividend Reinvestment Plan
Shareholders may increase their investment in our stock by enrolling in PepsiCo's Dividend Reinvestment Plan. We pay all fees associated with the plan. A brochure explaining this convenient plan is available from our transfer agent:

Manufacturers Hanover Trust Company
450 West 33rd Street
New York, New York 10001

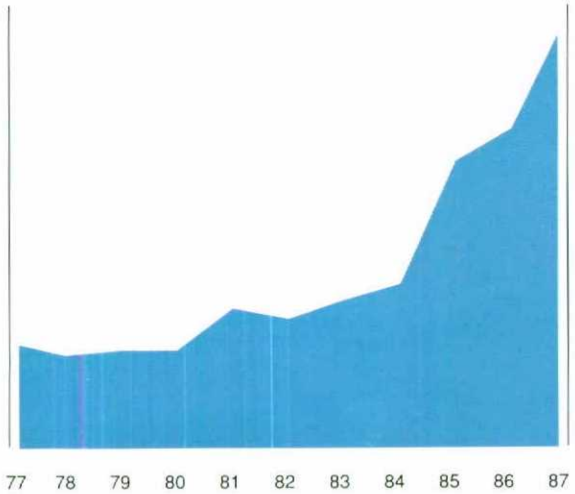
Stock Prices
The high, low and closing prices on the New York Stock Exchange, as reported by The Wall Street Journal, for each quarter of 1987 and 1986 were as follows:

1987	High	Low	Close
Fourth Quarter	**40 5/8**	**25 1/2**	**33 7/8**
Third Quarter	**42 1/4**	**35 3/8**	**38**
Second Quarter	**37**	**29 3/4**	**36 1/2**
First Quarter	**35 3/4**	**26**	**35**
1986			
Fourth Quarter	29 7/8	24 1/2	26 1/4
Third Quarter	35 5/8	27 3/4	28 3/8
Second Quarter	35 3/8	26 7/8	34
First Quarter	28 1/2	22	26 7/8

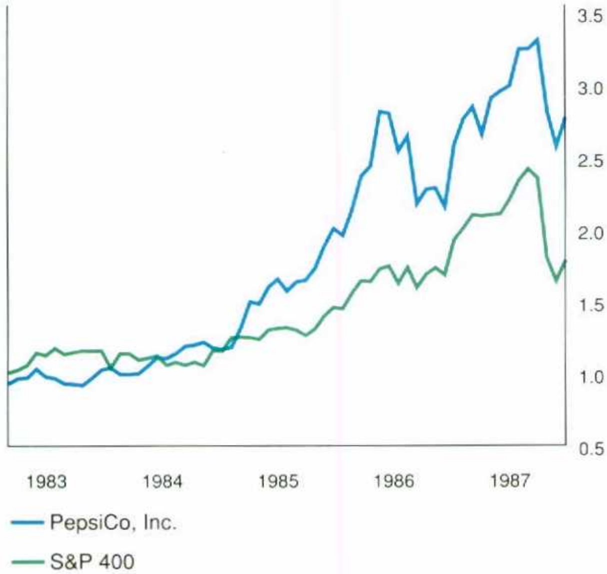
Stock Performance
As the accompanying chart illustrates, the return on PepsiCo Capital Stock compares favorably with the performance of the Standard & Poor's 400 over the past five years.

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made in 1965 was worth approximately $16,000 on December 26, 1987, assuming the reinvestment of dividends. Past performance is not necessarily indicative of future returns on investments in PepsiCo stock.

Year-End Market Price of Stock
(In Dollars)



Comparison Of Monthly Market Price Performance
Closing Price Indexed At 12/31/82



Principal Divisions

Soft Drinks

PepsiCo Worldwide Beverages
Somers, New York 10589
Roger A. Enrico, President

Pepsi-Cola Company
Somers, New York 10589
Craig E. Weatherup, President

Pepsi-Cola East
Somers, New York 10589
John M. Cranor, III, President

Pepsi-Cola South
4100 Alpha Road
Dallas, Texas 75244
Ronald W. Tidmore, President

Pepsi-Cola Central
500 Park Boulevard
Itasca, Illinois 60143
Christopher A. Sinclair, President

Pepsi-Cola West
1 City Boulevard West
Orange, California 92668
Christopher Hallenbeck, President

Pepsi-Cola International
Somers, New York 10589
Robert H. Beeby, President

PepsiCo Wines and Spirits International
Purchase, New York 10577
John G. Swanhaus, Senior Vice President and General Manager

Snack Foods

PepsiCo Worldwide Foods
Frito-Lay, Inc.
7701 Legacy Drive
Plano, Texas 75024
Michael H. Jordan, President

PepsiCo Foods International
400 Frito-Lay Tower
Dallas, Texas 75235
John S. Pingel, Jr., President

Restaurants

Kentucky Fried Chicken Corporation
1441 Gardiner Lane
Louisville, Kentucky 40213
Richard P. Mayer, Chairman

Pizza Hut, Inc.
9111 East Douglas
Wichita, Kansas 67207
Steven S Reinemund, President

Taco Bell Corp.
17901 Von Karman
Irvine, California 92714
John E. Martin, President

PepsiCo Food Service International
Purchase, New York 10577
Graham G. Butler, President

PepsiCo Directors and Officers

Directors

D. Wayne Calloway
Chairman of the Board and
Chief Executive Officer
PepsiCo, Inc.
Committee: Executive

Frank T. Cary
Retired Chairman and Chief Executive Officer, International Business Machines Corporation
Committees: Audit, Compensation, Executive

William T. Coleman, Jr.
Partner, O'Melveny & Myers
Committees: Audit, Compensation

Roger A. Enrico
President and Chief Executive Officer
PepsiCo Worldwide Beverages
Committee: Executive

Clifton C. Garvin, Jr.
Retired Chairman of the Board and
Chief Executive Officer
Exxon Corporation
Committees: Audit (chairman), Compensation, Executive

Michael H. Jordan
President and Chief Executive Officer
PepsiCo Worldwide Foods
Committee: Executive

Donald M. Kendall
Chairman of the Executive Committee
PepsiCo, Inc.

John J. Murphy
Chairman, Chief Executive Officer and President, Dresser Industries
Committees: Audit, Compensation

Andrall E. Pearson
Professor, Harvard Business School

Sharon Percy Rockefeller
Member, Board of Directors
Corporation for Public Broadcasting
Committees: Audit, Compensation

Robert H. Stewart, III
Vice Chairman of the Board
La Salle Energy Corporation
Committees: Audit, Compensation (chairman), Executive

Robert S. Strauss
Partner, Akin, Gump, Strauss, Hauer & Feld
Committees: Audit, Compensation

Dr. Arnold R. Weber
President, Northwestern University
Committees: Audit, Compensation

Executive Officers

D. Wayne Calloway
Chairman of the Board and
Chief Executive Officer

Donald M. Kendall
Chairman of the Executive Committee

Roger A. Enrico
President and Chief Executive Officer
PepsiCo Worldwide Beverages

Michael H. Jordan
President and Chief Executive Officer
PepsiCo Worldwide Foods

Robert G. Dettmer
Executive Vice President and
Chief Financial Officer

Randall C. Barnes
Senior Vice President, Strategic Planning and New Business Development

Robert L. Carleton
Senior Vice President and Controller

Donovan R. Christopherson
Senior Vice President, Restaurant Development

J. Roger King
Senior Vice President, Personnel

Edward V. Lahey, Jr.
Senior Vice President, General Counsel and Secretary

Joseph F. McCann
Senior Vice President, Public Affairs

Leonard Schutzman
Senior Vice President and Treasurer

Vice Presidents

Gerard W. Casey
Assistant General Counsel

Douglas M. Cram
Corporate Division Counsel

Allan B. Deering
Management Information Services

Lawrence F. Dickie
Associate General Counsel and
Assistant Secretary

James H. Ditkoff
Taxes

John J. Flaherty
General Auditor

James M. Griffith
Public Relations

Donald T. Haman
Tax Administration

Joseph J. Joyce
Assistant General Counsel

Margaret D. Moore
Investor Relations

Robert I. Pagnucco
Associate General Counsel

Dan R. Paxton
Human Resources

Charles W. Rogers
Compensation and Benefits

David L. Wright
Government Affairs

Assistant Officers

John J. Garand
Assistant Controller

Janet M. Lavine
Assistant Treasurer

Claudia E. Morf
Assistant Treasurer

Lawrence H. Meyer
Assistant Treasurer

Executive Offices

Purchase, New York 10577
(914) 253-2000

Shareholder Information

Financial Information

Security analysts and representatives of financial institutions are invited to contact:

Margaret D. Moore
Vice President, Investor Relations
Telephone: (914) 253-3035

Shareholder Inquiries

Questions concerning your dividend reinvestment account, dividend payments or address changes should be addressed to:

Manufacturers Hanover Trust Company
Security Holder Relations
P.O. Box 24935, Church Street Station
New York, New York 10249
Telephone: (212) 613-7147

Please mention PepsiCo, your name as printed on your stock certificate, your social security number and include your address and telephone number in all correspondence.

Shareholders' Meeting

The Annual Meeting of Shareholders will be held at PepsiCo World Headquarters on Anderson Hill Road, Purchase, New York, at 10 a.m. (EDT), Wednesday, May 4, 1988. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

If you need additional assistance or information, or would like to receive free of charge copies of PepsiCo's Form 10-K and 10-Q Reports filed with the Securities and Exchange Commission, contact:

Manager of Shareholder Relations
PepsiCo, Inc.
Purchase, New York 10577
Telephone: (914) 253-3055

Executive Offices

Purchase, New York 10577
(914) 253-2000

Design: Eisenman & Enock, Inc.
Printing: National Bickford Foremost
Major Photography: Stephen Wilkes. Still Life: Ben Rosenthal. Chairman's Portrait: Donald Miller.

New Products

A continuing stream of new products has been one of the keys to PepsiCo's success. Retail sales in 1987 of just these new products alone would create a new Fortune 400 company.

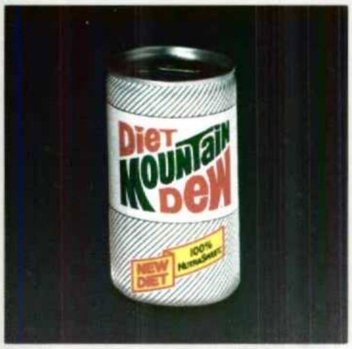
Snack Foods

Cool Ranch Doritos $218 Million

Cajun Spice Ruffles $ 81 Million

Soft Drinks

Diet Mountain Dew $120 Million



Restaurants

Pizza Hut Delivery $218 Million

Chicken Littles $ 94 Million

Steak Fajitas $ 48 Million

Soft Taco $ 93 Million

PEPSICO INC.

Frito Lay®

PEPSI

Pizza Hut®

TACO BELL®

Kentucky Fried Chicken®

PepsiCo, Inc. Purchase, New York 10577